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OVERSIGHT OF THE MANAGEMENT OF THE U.S. SYNTHETIC FUELS CORPORATION

A REPORT
PREPARED BY THE
SUBCOMMITTEE ON OVERSIGHT OF
GOVERNMENT MANAGEMENT
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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LETTER OF TRANSMITTAL

U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT OF
GOVERNMENT MANAGEMENT,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C., September 20, 1983.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Committee on Governmental Affairs, Washington, D.C.

DEAR MR. CHAIRMAN: The Subcommittee on Oversight of Government Management transmits the following report on the management of the Synthetic Fuels Corporation.

The Subcommittee held hearings on July 27 and 29, 1983, to examine the operations of the Board of Directors, which governs the Corporation, and to review the SFC's administrative expenses, particularly for consultants and for employee reimbursements. Also investigated were allegations of an improper agreement between two of the Directors.

The Subcommittee's principal finding is that the Corporation's activities have been impeded by a serious communications gap between the full-time and part-time Directors. Until recently, the role of the part-time Board members has not been commensurate with their responsibilities as trustees of the federally funded Corporation. Concerns about the adequacy of the SFC's management have interfered with the Board's ability to give its full attention to investment decisions and led three Directors to seek the resignation of the SFC President.

The Synthetic Fuels Corporation has had a troubled history, marked by management failures, an absence of planning and continuity, and missed opportunities. Despite a strong statutory mandate, the Corporation has made little headway in granting financial assistance to synfuels projects. In the Subcommittee's judgment, this slow progress is attributable to the conflicts within the Board of Directors, industry's doubts about the administration's commitment to the program, uncertainties about the Corporation's policies, and shifting economic and energy conditions.

The Subcommittee believes, however, that the Corporation is now making progress and that the recommendations in this report lay the groundwork for further improvements. The report includes specific proposals for reforming the Corporation's organization, procurement practices, and conflict-of-interest procedures.

The Subcommittee supports the continuation of the Synthetic Fuels Corporation. While the promise of the Energy Security Act has not yet been fulfilled, the development of a viable synthetic fuels industry should remain a priority for the United States, and the Synthetic Fuels Corporation can still make an enormous contribution to the goal of energy self-sufficiency.

Sincerely,

WILLIAM S. COHEN, *Chairman.*

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SUMMARY

The Oversight of Government Management Subcommittee, as a result of its hearings and investigation, makes the following findings and recommendations concerning the management of the U.S. Synthetic Fuels Corporation.

FINDINGS

1. The Synthetic Fuels Corporation has made only desultory progress in fulfilling its statutory mandate. The Corporation has had a troubled past, marked by management failures, an absence of planning and continuity, and slow decision-making. To date, the SFC has completed only one financial assistance agreement with a synfuels project sponsor. The Subcommittee attributes this slow progress to industry's doubts about the Administration's commitment to assisting synthetic fuels projects, uncertainties about the Corporation's policies, shifting economic and energy conditions, and conflicts within the Board of Directors.

2. The SFC has been hampered by a breakdown in communications between its full-time and part-time Directors. These problems led three of the Directors to request the replacement of the Corporation President and to ask for a reorganization of the SFC's operations. In the Subcommittee's judgment, the role of the part-time Board members has not been commensurate with their responsibilities as trustees under the Energy Security Act. The SFC has been run more like a family-owned corporation than like a public, federally funded entity charged with the responsibility of wisely investing billions of tax dollars.

Warning signals of serious problems, including a critical consultant's report, repeated criticisms from the outside Directors, and negative comments in an industry survey, were not heeded by management. The failure of the full-time Directors to act on these concerns crystallized the polarization of the Board.

3. The Corporation's procurement practices need improvement. With the exception of consultant contracts, the SFC's procurements for goods and services are highly competitive and well-documented. However, all of the individual consultant contracts awarded by the Corporation between October 1981 and June 30, 1983, were awarded on a sole-source basis. These 51 contracts totaled more than $600,000. In some of the contract files reviewed by the Subcommittee, the justification for the sole-source award was weak; the scope of the consultant's work was not clearly defined, and the need for an outside consultant was not evident. The Subcommittee believes that some of the consultant contracts were not awarded solely on the basis of merit, but rather because the consultant was a former business acquaintance of an officer of Corporation. While past business dealings should not be

a disqualifying factor, the Corporation failed to provide adequate evidence that the selection of the contractor was not due to bias or favoritism.

The SFC Procurement Manual, while generally excellent, does not contain sufficient safeguards to protect against abuses in the use of consultants. The provisions of the Manual designed to accommodate legitimate sole-source procurements are being used to allow the routine award of sole-source contracts to individuals who do not have the unique experience that would justify a non-competitive award.

4. A conversation between two of the Directors during which President Victor Schroeder asked Milton Masson to support his reorganization proposal and Mr. Masson asked Mr. Schroeder for a personal favor created the appearance of impropriety. While the Justice Department found insufficient evidence to warrant prosecution or further investigation, the Subcommittee believes that the two Directors' agreement indicates an insensitivity to ethical considerations and was contrary to the spirit, if not the letter, of the SFC's own Standards of Conduct.

The Subcommittee further finds that the Chairman did not act promptly in referring the allegations to the Inspector General for a preliminary investigation. This delay exacerbated tensions among the Corporation's staff, directors, and officers and created a cloud over the SFC's operations.

5. During the course of its investigation, the Subcommittee has discovered differing opinions about the applicability of certain federal criminal laws to the Corporation's employees because of language in the Energy Security Act exempting SFC Directors, officers, and employees from "any law of the United States relating to government employment," except as specifically provided by the Act. While the Subcommittee believes that Congress clearly did not intend to exempt the Corporation's staff from conflict-of-interest, bribery, and other criminal laws affecting Federal employees, the Subcommittee is concerned about the ambiguity regarding the applicability of these criminal statutes.

6. In the Subcommittee's judgment, the SFC has diligently implemented the financial conflict-of-interest sections of the Energy Security Act. These provisions include mandatory recusal by a Director from voting on any issue before the Board in which he or she has a financial interest. This recusal requirement may be waived, however, whenever the Director publicly discloses the interest and the Board determines that the interest is too remote or inconsequential to affect the integrity of the Director's participation. While the SFC has developed effective procedures to implement the current requirements, the Subcommittee believes that the Senate Energy and Natural Resources Committee should reevaluate the recusal provisions to determine if they have been effective in promoting public confidence in the decisions of the Board and are consistent with the goals of the Act.

7. The Subcommittee supports the findings of the SFC Inspector General's fiscal 1982 audit which questioned certain reimbursements and claims involving Victor Schroeder, then-President of the Corporation. The Subcommittee believes that Mr. Schroeder's receipt of $19,500 as reimbursement for a real estate commission on a house he

purchased in Virginia was improper. (Mr. Schroeder has since repaid the money with interest.) The Subcommittee also concludes that further investigation into Mr. Schroeder's claims for a mortgage interest rate differential is warranted because he did not sell his old house in Georgia when he relocated to the Washington area.

8. The Subcommittee believes that Mr. Schroeder's decision to resign as President reflects his concern for the best interests of the Corporation. His resignation will allow the Directors to choose a new President who will enjoy their full support and confidence. That should mend the division in the Board and permit the Corporation to focus its energies on the synfuels investment program.

9. The Subcommittee is encouraged by the recent progress the SFC has made in improving its operations. In particular, the Subcommittee commends the Chairman for his increased consultation with the part-time Directors and for his efforts to reorganize and strengthen the Corporation.

RECOMMENDATIONS

1. The Subcommittee recommends that the SFC Inspector General conduct a management audit focusing on the Corporation's organizational structure, internal controls, and planning. This audit should be future-oriented and should provide specific recommendations for the Board of Directors and the new President to consider. To be effective, the audit must be conducted by an experienced individual with extensive knowledge of the Corporation; therefore, it should not be contracted out to a consultant.

2. The Board of Directors should develop a strategic plan for accomplishing the synfuels investment program to underscore its commitment to the objectives of the Energy Security Act. Such a plan should go beyond the diversity goals that the SFC has already announced and should specify the resources, personnel, and timetable for reaching the Corporation's investment priorities.

3. The SFC Procurement Manual should be revised to establish a preference for the use of competition in the award of consultant contracts to the maximum extent practicable. The Subcommittee recommends that the Procurement Manual be strictly followed to ensure that the Corporation's contracting is highly competitive, well-documented, and fully warranted. In addition, the Corporation should decrease its reliance on outside consultants. In the Subcommittee's judgment, the Corporation has a highly paid and expert staff which should be able to provide many of the services for which individual consultants have been hired.

4. The Subcommittee recommends that Executive Order 11222, which prescribes standards of conduct for government employees, be extended to cover the full-time employees and officers of the SFC. The Subcommittee also believes that the Energy Security Act should be amended to clarify that the employees, officers, and Directors of the Corporation are not exempt from Federal criminal laws applying to Government employees.

5. The Board of Directors should establish disciplinary procedures for violations of the Corporation's ethical standards. Whenever appropriate, the Ethics Officer and the Inspector General should rec-

ommend to the Board disciplinary sanctions for ethical violations which do not warrant referral to the Department of Justice but are contrary to established SFC standards of conduct.

6. The Subcommittee recommends to the Chairman that, whenever information suggesting improper conduct by a Director, officer, or employee of the Corporation comes to his attention, he should take immediate action to resolve the allegations. Generally, an allegation of criminal activity should be referred either to the Inspector General for a preliminary investigation or directly to the Department of Justice. Information concerning possible unethical conduct should be referred to the Ethics Officer for review.

7. To promote greater accuracy in recusal determinations, the Subcommittee proposes that all part-time Directors file annual confidential financial disclosure statements with the Ethics Officer. This requirement would ensure that the Ethics Officer is fully informed when evaluating whether or not a Director should participate in a particular matter before the Board.

INTRODUCTION

Acting on its mandate to oversee "the efficiency and economy of government operations," the Senate Subcommittee on Oversight of Government Management examined the management of the U.S. Synthetic Fuels Corporation. This federally funded Corporation was created in 1980 to foster the development of a commercial synthetic fuels industry by investing potentially as much as $88 billion in synthetic fuels projects.

In view of the magnitude of tax dollars at stake, the Subcommittee was concerned about the quality of the management of the SFC. Our inquiry focused on the operations of the Board of Directors, which governs the Corporation, and on the economy and efficiency of the SFC's administrative practices. The Subcommittee considered the following specific issues:

- the Corporation's progress in meeting the goals of the Energy Security Act;
- the SFC's external and internal communications;
- the dissension among the Directors;
- the Corporation's use of consultants;
- allegations of an improper agreement between two of the Directors; and
- the Corporation's administrative expenses.

The Subcommittee held two days of hearings to evaluate these issues. Testifying before the Subcommittee on July 27, 1983, were the following witnesses:

Edward E. Noble, Chairman, U.S. Synthetic Fuels Corporation.

Victor A. Schroeder, Vice Chairman and President, U.S. Synthetic Fuels Corporation, accompanied by Jimmie R. Bowden, Executive Vice President, U.S. Synthetic Fuels Corporation.

Robert Coughlan, Santa Fe, New Mexico.

S. Kenric Lessey, Inspector General, U.S. Synthetic Fuels Corporation.

On July 29, 1983, the witnesses were: Donald Thibeau, Executive Assistant to the Chairman, U.S. Synthetic Fuels Corporation.

Panel: Members, Board of Directors, U.S. Synthetic Fuels Corporation: John B. Carter, Milton M. Masson, Jr., Robert A. G. Monks, C. Howard Wilkins, Jr.

Based on our hearings and investigation, the Subcommittee reached the findings and recommendations in this report. The Subcommittee wishes to commend the Directors, officers, and staff of the Synthetic Fuels Corporation for their cooperation during the inquiry and for their forthright testimony at the hearings.

BACKGROUND AND HISTORY OF THE SYNTHETIC FUELS CORPORATION

I. PURPOSE AND STRUCTURE OF THE SFC

In response to the energy shortages of the 1970s, Congress passed the Energy Security Act of 1980,[1] which was designed to reduce our Nation's dependence on imported oil by encouraging the development of a domestic synthetic fuels industry.[2] Congress established a national goal of achieving a synthetic fuels production capability equivalent to 500,000 barrels of crude oil per day by 1987, increasing to 2 million barrels per day by 1992.[3]

The United States Synthetic Fuels Corporation was created by Title I of the Act as a long-range program to stimulate commercial development of synthetic fuels. The SFC is a federally chartered financial enterprise which is authorized to provide several forms of financial assistance to foster the production of synfuels. SFC-supported projects are intended primarily to convert the Nation's coal, oil shale, tar sands, peat, and certain heavy oil resources into synfuels which can be used as substitutes for natural gas and petroleum, including crude oil, petroleum products and chemical feedstocks. The legislative history of the Energy Security Act explains that Congress expected the SFC to function "much like a private corporate entity such as a bank or other financial institution" to provide financial assistance to the private sector.[4]

During the first phase of its existence, the Corporation is empowered to obligate up to $20 billion in financial assistance to worthy projects. Potentially, the SFC may place at risk $88 billion through investments in synthetic fuels production.

Congress viewed the Corporation's task as so urgent and the energy crisis as so severe that it exempted the SFC from many of the usual statutory restraints that govern—and limit—the authority and operations of Federal agencies, despite the fact that the Corporation is funded entirely from the Federal treasury.[5] The SFC, for example, is not subject to the Administrative Procedure Act or Federal procurement laws, and its Directors can only be removed from office for neglect of duty or malfeasance.[6]

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[1] Pub. L. No. 96–294, 96th Cong., 2d Sess., 42 U.S.C. §§ 8701 et seq.

[2] Title I of the Act consists of two programs to accelerate the development of a synthetic fuels industry in the United States. Part A of Title I amended the Defense Production Act to establish a "fast-track" interim program using existing federal departments and agencies to expedite the development and production of synthetic fuels for national defense needs. This interim program, which has since been terminated, was conducted by the Department of Energy's Alternative Fuels Production Program and a joint DOE-Department of Defense program. Part B of Title I created the Synthetic Fuels Corporation. The "fast-track" program went into stand-by status when the SFC became fully operational.

[3] 42 U.S.C. § 8701(b)(2).

[4] Joint Explanatory Statement of the Committee of Conference on S. 932, H.R. Committee on Banking, Finance and Urban Affairs, 96th Cong., 2d Sess., Compilation of the Energy Security Act of 1980, and 1980 Amendments to the Defense Production Act of 1950, 175 at 198.

[5] See 42 U.S.C. § 8775.

[6] Id., see also 42 U.S.C. § 8712(b)(3).

The Corporation was given this latitude and freed from the standard ties that bind most Federal departments so that it could function more like a private entity, an investment bank.

II. THE BOARD OF DIRECTORS

Section 116 of the Act vests the powers of the SFC in a seven-member Board of Directors composed of a Chairman and six other Directors, each of whom is appointed by the President with the advice and consent of the Senate. Not more than four of the Directors may be members of any one political party. The Chairman is appointed for a seven-year term and serves on a full-time basis. The other Directors may serve on a full- or part-time basis, the status of which is designated by the President at the time of the appointment. Directors who serve full time cannot hold any other salaried positions, while part-time Directors are restricted only from holding any full-time salaried Government position. Upon the expiration of the terms of the first set of Directors, each Director serves a seven-year term. The Act staggers the terms of the initial set of Directors so that terms do not expire simultaneously. Subsection 116(b)(3) of the Act specifies that each Director, including the Chairman, is removable only by the President for only "neglect of duty or malfeasance in office."

The Act designates the Chairman as the chief executive officer of the SFC and makes him responsible for the SFC's "management and direction." All powers of the Corporation, except those specifically given to the Chairman, rest with the Board. The Board sets all major policies, determines guidelines and criteria for soliciting and evaluating proposals, and makes final judgments on the award of financial assistance to projects. Also, the statute requires the Board to establish offices and fix the compensation of officers of the SFC and to "provide a system of organization to fix responsibility and promote efficiency." [7]

The Energy Security Act places restrictions on the Board's authority to delegate its powers to others within the SFC.[8] For example, the Act specifies that the Board may not delegate its duty to develop a comprehensive strategy, prescribe terms and conditions of loans or financial assistance, or issue solicitations for proposals. Any Board function other than those specifically enumerated in section 119(a) as non-delegable may be delegated to the Chairman or other Directors only by resolutions of the Board. Similarly, the Chairman may delegate duties assigned to him to full-time Directors, officers and employees of the Corporation only by written instrument.

III. OFFICERS AND EMPLOYEES

The authority to establish offices, appoint officers, and fix the compensation of officers and employees rests with the entire Board.[9] The statute directs the Board to establish compensation rates comparable to those for other federal employees, to the maximum extent possible. If the Board determines that higher salaries are necessary to attract qualified persons for the positions, it must make these recommendations to the President, who has 30 days to disapprove the salary proposal. The statute authorizes the SFC to employ no more than 300 full-time professional employees at any one time. The Corporation currently has 177 employees.

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[7] 42 U.S.C. § 8713(b)(3).
[8] 42 U.S.C. § 8715(a).
[9] 42 U.S.C. § 8713(b).

IV. Inspector General

In order to ensure the integrity of SFC activities and operations, the Congress provided an Inspector General within the Corporation who reports to and is under the supervision of the Board of Directors.[10] The IG has the responsibility to "supervise, coordinate, and provide policy direction for auditing, investigative and inspection activities" relating to the economy and efficiency of, or detecting fraud and abuse in, the SFC. The IG is also given the responsibility to make recommendations to the Board and the Congress for correcting deficiencies in and improving the programs of the SFC. The statute specifies that neither the Board nor any other officer or employee of the SFC may prevent the IG from investigating or auditing a matter within his jurisdiction.

V. Phases and Financial Resources of the SFC

The Synthetic Fuels Corporation has a maximum life of 12 years, which is divided into two phases of operation. In its first phase, the SFC is authorized to spend up to $20 billion to provide financial assistance to worthy synthetic fuels projects. Congressional appropriations to finance the SFC operations are deposited in the Energy Security Reserve of the United States Treasury. In P.L. 96–304, the Congress stated that up to $17.5 billion of the Energy Security Reserve would be available to the SFC.[11] Of these funds, $6 billion were made immediately available to cover the expenses and commitments of the Corporation, and an additional $6.2 billion were made available for these purposes on June 30, 1982. The remaining $5.3 billion were to be made available to the SFC from funds appropriated to the Department of Energy for the interim program under the Defense Production Act and the Non-Nuclear Energy Research and Development Act of 1974.[12] In February, 1982, President Reagan transferred approximately $2.7 billion from the interim program to the SFC. As a result of these funding sources, the SFC had a total of approximately $14.9 billion funds with which to operate by June 30, 1982. The Act specifically authorizes the Corporation to spend up to $35 million annually on its own administrative expenses and $10 million on generic studies. These amounts are subtracted from the amounts in the Energy Security Reserve.

By June 30, 1984, the Corporation must develop a comprehensive plan for achievement of the production goals prescribed by the Act.[13] Called the "comprehensive strategy," this plan must set forth the recommendations of the Board on the goals of the SFC and schedules for their achievement. Both the Act and its legislative history provide ample guidance to the Corporation on what factors should be considered in developing the comprehensive strategy. Once submitted to the Congress, the strategy must be approved by joint resolution in order to trigger the second phase of the SFC. Upon approving the strategy, the Congress may provide subsequent appropriations to the Corporation up to an additional $68 billion. In any event, the Corporation is not authorized to obligate any funds after September 30, 1992, and must terminate all activities by September 30, 1997. Upon termination, the Corporation's outstanding contracts for financial assistance will be transferred to the Secretary of the Treasury for administration.

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[10] 42 U.S.C. § 8718.

[11] See Supplemental Appropriations and Rescission Act of 1980, Pub. L. 96–304, 96th Cong., 2d Sess. (1980).

[12] See Id.

[13] 42 U.S.C. § 8722(b).

VI. Types of Financial Assistance Provided by the SFC

The Energy Security Act authorizes the SFC to commit financial assistance to worthy synfuels projects in the following order of decreasing priorities: price guarantees; purchase agreements or loan guarantees; loans; and joint ventures.[14]

The Act requires the Board to give preference to proposals that are likely to result in the least commitment of financial assistance by the Corporation and the lowest unit production cost within a given technological process. In deciding which synfuels projects to support, SFC must also consider the range of available technologies, the overall production potential of each technology, and the potential of each technology for compliance with environmental regulations.

Whenever practicable, the SFC Board is directed to award financial assistance on the basis of competitive bids. If SFC solicits bids for a synfuels project and none is received, or if those received are unacceptable to SFC's Board, the Board can negotiate a financial assistance contract for a specific project after reporting to the appropriate House and Senate authorities. The SFC is authorized to require appropriate security and collateral for the repayment of any obligations owed to it. All forms of financial assistance granted by SFC are general obligations of the United States backed by its full faith and credit.

A recipient of SFC's financial assistance must develop a plan to monitor a project's environmental and health-related emissions. The plan must be acceptable to SFC's Board of Directors and it must be developed in consultation with the Administrator of the EPA, the Secretary of Energy, and appropriate State agencies. Under certain limited circumstances, SFC could acquire control of or purchase and leaseback synfuels projects, subject to congressional review and veto. Such control would have to be disposed of within 5 years after acquisition.

VII. Membership of the Board of Directors

To date, two sets of Directors have been appointed to manage the Corporation. On September 10, 1980, President Carter nominated then-Secretary of Energy John C. Sawhill as the first Chairman of the SFC. On September 19, 1980, President Carter nominated 5 persons to the Board: John De Butts, Catherine Cleary, Frank Savage, Cecil Andrus, and Lane Kirkland. Because the Senate recessed in October of that year without acting on the nominations, President Carter filled

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[14] 42 U.S.C. § 8731(b)(2)(B).

6 of the 7 Board seats on October 5 with recess appointments. Shortly after taking office in January 1981, however, President Reagan accepted the resignation of all of the Board members. After the resignation of the initial Board, the officers of the SFC continued the activities of the Corporation without a new Board in place.

On May 13, 1981, the Senate confirmed Edward E. Noble, nominated by President Reagan, as Chairman of the SFC. As Chairman, Mr. Noble was appointed to a seven-year term that will expire on May 14, 1988. In September 1981, four more Board members were confirmed by the Senate. These Directors, who are all still serving on the SFC Board, are Victor A. Schroeder, whose six-year term will expire September 14, 1987, C. Howard Wilkins, whose five-year term will expire on September 14, 1986, Victor M. Thompson, Jr., whose four-year term will expire on September 14, 1985, and Robert A. G. Monks, whose three-year term will expire on September 14, 1984. On August 16, 1982, the Senate confirmed the last two members of the Board, John B. Carter, Jr., whose two-year term will expire on August 16, 1984, and Milton M. Masson, Jr., whose one-year term expired on August 16, 1983.[15] All Directors, except the Chairman, are part-time Directors. Mr. Schroeder, however, served the Corporation on a full-time basis from October 28, 1981 to August 26, 1983, in his capacity as President and Chief Operating Officer of the SFC.

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[15] Section 116(b)(2) of the Act specifies that upon expiration of a term, a Director may continue to serve in office for a maximum of one year or until a successor has been appointed and has taken his or her place on the Board. As of the date of printing, Mr. Masson is continuing to serve as a Director pursuant to this section of the Act.

FINDINGS AND RECOMMENDATIONS

The Oversight of Government Management Subcommittee has the responsibility to promote effective management of Federal programs, high ethical standards among government officials, economical procurement of goods and services, and prudent spending of tax dollars. The Subcommittee examined allegations that the Synthetic Fuels Corporation was deficient in all of these areas and that these problems were impeding the Corporation's ability to fulfill its statutory mandate.

The Subcommittee's analysis is set forth in the findings and recommendations in this section of the report.

I. THE CORPORATION'S CONTRIBUTION TO SYNFUELS PRODUCTION

A. INVESTMENT IN SYNTHETIC FUELS PROJECTS

The Energy Security Act established national synfuels production goals of 500,000 barrels of oil equivalent per day by 1987 and 2 million barrels per day by 1992. However, the SFC Executive Vice President, Jimmie Bowden,[16] testified that the Corporation only expects to have financed projects producing 150,000 barrels of oil equivalent a day by 1989—falling far short of the statutory goals.

To date, the Synthetic Fuels Corporation has issued three general solicitations requesting proposals for financial assistance and has received more than 100 submissions. The proposals fall into four resource categories: oil shale, coal or peat, tar sands or heavy oils, and hydrogen from water by electrolysis. Most of these proposals have been rejected because they did not meet SFC criteria for project strength and maturity.[17] The Corporation has negotiated with several of the remaining sponsors that were considered worthy of eventual support.

As a result of these negotiations, the Corporation has issued four "letters of intent" to projects which are sufficiently mature to warrant serious negotiations about the terms and conditions of financial assistance but are not yet ready to enter into final agreements.[18]

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[16] On September 8, 1983, Executive Vice President Jimmie Bowden submitted his resignation to Chairman Noble, effective immediately. He informed the Chairman that he was resigning in order to give the Chairman a "free hand to restructure management of the Corporation." Mr. Bowden stated, "As I have reviewed the new System of Organization approved by the Board of Directors on August 29, 1983, I have become convinced that my incumbency as Executive Vice President complicates your job of reorganizing the Corporation to move forward with renewed vigor." News Release, United States Synthetic Fuels Corporation, September 9, 1983. Mr. Bowden will remain with the Corporation until October 31, 1983, in order to effect a smooth transition. On September 9, 1983, Chairman Noble appointed Leonard C. Axelrod, Vice President-Technology and Engineering, to serve as Acting Executive Vice President and Chief Operating Officer until the Board fills the position.

[17] See, Annual Report of the United States Synthetic Fuels Corporation, January 1983. See also Minutes of the Board of the Synthetic Fuels Corporation, January–July 1983, retained in Subcommittee files.

[18] Id.

In addition to its general solicitations, the SFC has issued a targeted solicitation restricted to western oil shale projects capable of producing at least 10,000 barrels per day of oil equivalent and two other targeted solicitations restricted to coal-based synfuels projects. The Corporation has not accepted any of the western oil shale project proposals submitted in response to that solicitation.[19]

The Board of Directors did not grant its first award of financial assistance until July 28, 1983. The Corporation has agreed to provide up to $120 million in price guarantees over the next five years to the Cool Water coal gasification/combined cycle cogeneration project in Daggett, California. It is expected to produce 4,300 barrels per day of synthetic gas, once it is operational.[20]

The Corporation's slowness in awarding financial assistance has been criticized by Members of Congress, including the Senate Appropriations Committee. In its December 1982 statement on the Department of the Interior and Related Agencies Appropriations Bill (H.R. 7356), the Committee stated:

> In the Committee's judgment, the slow pace of progress by the SFC has been responsible in part for the recent withdrawal by several industrial sponsors from certain of these projects and the withdrawal of other proposals. Unfortunately, while the first solicitation closed belatedly on January 4, 1982, and the second solicitation . . . closed on June 1, 1982, no awards of or commitments to award financial assistance have been made. The Committee believes that this record can, and should, be improved.[21]

The Appropriations Committee compared the record of the SFC with the progress the Department of Energy made in only nine months when it granted financial assistance to three projects under an interim program authorized by the Defense Production Act and the Non-Nuclear Energy Research and Development Act of 1974.

While the Department of Energy was not faced with the startup problems affecting the Synthetic Fuels Corporation, the Subcommittee believes that the Corporation could have moved more aggressively in funding projects without shortchanging its thorough technical and financial reviews.

Corporation officials generally have blamed falling oil prices for their inability to find projects worthy of Federal financial assistance.[22]

While lower oil prices make loans and loan guarantees less attractive to industry, price guarantees become more appealing during a time of declining energy prices. By guaranteeing a set price for a synthetic fuel, the Corporation can shield a project sponsor from price fluctuations, thus lowering the risk for industry. The Subcommittee does not believe that economic changes are the sole cause of the SFC's difficulties because of the availability of these price guarantees.

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[19] Id.

[20] Id.

[21] Explanatory Statement of the Recommendations on the Senate Committee on Appropriations on the Department of Interior and Related Agencies Appropriations Bill, H.R. 7356, U.S. Senate, 97th Cong., 2d Sess.. December 9, 1982, *Oversight of the Management of the U.S. Synthetic Fuels Corporation*. Hearings before the Subcommittee on Oversight of Government Management of the Committee on Governmental Affairs, U.S. Senate, 98th Cong., 1st Sess., July 27 and 29, 1983 (hereinafter Hearing Record) at 182.

[22] See, e.g., Hearing Record at 12.

The slow progress in the investment program is troubling because Congress will have insufficient evidence to consider next year when deciding whether the second phase of the Corporation's activities should be implemented. The Energy Security Act directs the Corporation to submit to Congress its Comprehensive Strategy Report by June 30, 1984. According to the Act, this report is to include:

> findings, based upon accompanying comprehensive reports, regarding synthetic fuel projects which received financial assistance . . . with respect to (i) the economic and technological feasibility of each such project including information on product quality, quantity, and cost per unit of production; and (ii) the environmental effects associated with each such project . . . [23]

Since no SFC-assisted project will be producing synthetic fuels by the deadline for the Comprehensive Strategy Report, it will be impossible for the Corporation to provide these findings. Congress, in turn, will have a difficult time assessing the value of the Corporation's investments.

B. THE ADMINISTRATION'S COMMITMENT: MIXED SIGNALS TO INDUSTRY

Part of the difficulty that the SFC has experienced in moving forward may be the result of industry's doubts about the commitment of the Administration to the synfuels program.

Several top officials of the Corporation, including Chairman Noble, Mr. Schroeder, and Charles Cowan, the Vice President for Projects, served on the Reagan Administration Transition Team. Both Mr. Noble and Mr. Schroeder have ties with the Heritage Foundation, a strong opponent of the SFC. Mr. Noble, in fact, is a trustee of the Foundation. At the Subcommittee hearings, Mr. Schroeder testified that the Heritage Foundation paid the expenses that he and his wife incurred while serving on the Transition Team. Mr. Schroeder pointed out, however, that he had voted for the continuation of the Corporation.

Mr. Noble candidly testified that, as the head of the Transition Team, he had recommended to the President the termination of the SFC because he had "the feeling that the Corporation had the potential for having a lot of mischief . . . and I questioned the need of synthetic fuels very strongly. " [24] When he was appointed to head the Corporation, Mr. Noble said, he changed his mind about the need to develop a synthetic fuels capability in the United States.

While the Subcommittee does not doubt the sincerity of Mr. Noble's change of opinion, the President's decision to appoint an individual known as an opponent of the Corporation may have contributed to industry's perception that the Administration really was not backing the program.[25]

Industry's skepticism is evident in a survey conducted by the Inspector General's office from December 1981 to December 1982.[26] The survey, "Project Indigo," reports industry's perceptions of SFC activities during the First and Second Solicitations. Individuals interviewed represented organizations which have submitted projects to the Corporation, potential equity sponsors for the projects, investment banking houses, engineering companies, and law firms with direct contact with the Corporation. Although these industry representatives both criticized and praised aspects of the Corporation's operations, the survey reveals considerable doubt about the SFC's effectiveness and commitment. For example, the survey contains the following statements:

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[23] 42 U.S.C. § 8722(b)(3)(E).

[24] Hearing Record at 6.

[25] See, e.g., Jaroslovsky, Rich, "U.S. Readies Grants to Synfuels Projects Amid Fears Program Is Being Demoted," *Wall Street Journal*, June 19, 1981, Hearing Record pp. 177–8.

[26] "Project Indigo" (Industry Survey), Office of Inspector General, United States Synthetic Fuels Corporation, Hearing Record, pp. 213–27.

- There was almost complete agreement among respondents that the decision-making process at the SFC was too slow . . . Very little was done throughout 1981 and 1982. A number of industry representatives characterized these as lost years.

- It was asserted by several industry representatives that, had the Corporation not been so conservative and so hesitant, several of the major projects might have been saved by the issuance of a Letter of Intent.

- Nearly all respondents felt the Corporation had not done a good job in cultivating industry. Top management should have been out explaining the SFC program and encouraging sponsors, but this was not done . . . The SFC is learning that it has to get out and sell its program.

- Most of the industry representatives expressed concern over the lack of clarity of corporate policies and objectives.

- The SFC communication with sponsors was generally perceived to be insufficient.

At the hearing, Senator Cohen asked Inspector General S. Kenric Lessey whether there was a "perception on the part of industry that there were divided or mixed signals coming out of the Administration with respect to synfuels." Mr. Lessey replied: "Yes, sir, there were."

The Subcommittee believes that these mixed signals contributed to the slow progress of the Corporation. Recent progress, such as the July agreement with the Cool Water sponsors and the issuance of letters of intent, should promote more confidence in the Corporation's commitment and ability. The Subcommittee also recommends that the Corporation continue its outreach efforts to attract new project proposals. The Directors should also take every opportunity to affirm publicly and privately their support for the development of a domestic synfuels industry.

II. SFC COMMUNICATIONS

Without good communications, no corporation, Federal agency, or any other organization can function effectively. During its investigation and hearings, the Subcommittee scrutinized the quality of the SFC's communications, with particular emphasis on communication among the Corporation's Directors.

A. DIVISION WITHIN THE BOARD OF DIRECTORS

The Subcommittee found evidence of escalating dissension within the SFC's Board of Directors. The Subcommittee discovered that a division had emerged between the full-time Directors and some part-time members of the Board. The full-time Directors were Chairman Noble, who as the Chief Executive Officer of the Corporation is responsible for the "management and direction" of the SFC, and Victor A. Schroeder, who was President of the Corporation at the time of the Subcommittee hearings. Although Mr. Schroeder was designated by President Reagan as a part-time Director at the time of his appointment, he had, until his resignation effective August 26, 1983, worked full time for the Corporation in his capacity as President and Chief Operating Officer. As President, Mr. Schroeder acted as the Chairman's principal assistant and adviser on all policy matters and held full responsibility for the day-to-day operations of the SFC. The remaining Board members, Messrs. Carter, Masson, Monks, Thompson and Wilkins, are the part-time Directors.

The Subcommittee learned that disagreement among members of the Board concerning the policies and direction of the SFC has existed for over a year. Much of this disagreement has centered around two major concerns of some of the part-time Directors: the lack of a strategic plan to govern the operations of the Board and the limited involvement by the part-time or "outside" Board members in formulating the decisions of the Corporation.

At its July 29 hearing, Subcommittee members questioned three part-time Directors extensively on the apparent division within the Board. Mr. Monks testified that his own dissatisfaction could be traced back to February 1982. At that time, he expressed his concern that the Board lacked an overall strategy or "strategic plan" to govern the operations of the Corporation.

One of the first actions of a board of directors of any corporation or organization, regardless of its size, should be to create a plan as a blueprint for the future actions of the organization. Such a plan would enable the Corporation to evaluate its progress against standards which it had established for itself and would set forth the short- and long-term objectives of the Corporation.

The Synthetic Fuels Corporation also needed to define clearly the duties and responsibilities of the Directors and officers in meeting the objectives established by the Board in a strategic plan and by the Congress in the Energy Security Act. Such a system of organization would set forth the respective functions of the Directors and officers, particularly the part-time Directors vis-a-vis management. Because all Directors are fiduciaries and responsible for the actions of the Board, their roles and duties should be clearly delineated. Specifically, Mr. Monks viewed this as necessary under subsection 117(b)(3) of the Energy Security Act which requires the Board to "provide a system of organization to fix responsibility and promote efficiency," a responsibility which must be performed by the Board unless it delegates this authority to the Chairman or an SFC officer by formal resolution.

In February 1982, Mr. Monks conveyed his views on the need for a strategic plan to Mr. Noble, Mr. Schroeder, and the General Counsel of the SFC, Edward F. Cox, in a memorandum. This document, entitled "SFC—Concerns and Strategy," proposed various factors that the Directors might consider for a "strategic plan" so that the Board could "organize our procedures and allocate our resources in a disciplined manner so as to achieve the exact result desired at as little risk and cost as possible."[27] Included in the proposed strategic plan were preferences which the Board might establish in its methods of financing projects and an analysis of some of the requirements that are set forth in the Energy Security Act. While the members of the Board might have disagreed on the precise preferences and direction suggested for the SFC, the document was intended to encourage the management and the Board to establish parameters within which the Board would operate.

From the testimony, it seems clear that despite the importance of having a game plan for the Corporation's operations, the Board never collectivey devised one.

Mr. Wilkins testified that he, too, was deeply concerned by the activities of the Board since early in his tenure and that his major dissatisfaction stemmed from the fact that "there seemed to be no policy" governing the Board's actions. He noted that while the "outside" Directors gave the inside management opportunities to develop policies, the Directors became increasingly impatient after a number of months when no policies or clear divisions of authority were formulated by management.

Following these early attempts to have the Corporation establish a working plan of operation, some of the part-time Directors began to question the adequacy of the overall management of the SFC. This became apparent in August 1982, when some of the Directors traveled to South Africa to view the development of synthetic fuels in that country. The Subcommittee learned that on the trip, Mr. Monks and Mr. Wilkins became increasingly uneasy over the question of "who was running" the Corporation. While the two outside Directors met with Mr. Noble and Mr. Schroeder in South Africa to discuss the proper division of authority within and operation of the Corporation, they were dissatisfied with the response they received, and returned home without any clear sense of who was in charge at the SFC.

The dissatisfaction within the Board continued into the fall of 1982 when the final two Directors, Messrs. Carter and Masson, took their seats on the Board. A prevalent view developed among three of the part-time Directors that there was a distinct gulf growing between the "inside" and "outside" Directors. As Mr. Carter testified at the hearing:

> At the first Board meeting that I went to . . . I got the impression these fellows [the part-time Directors] had been ignored. Last year I tried to reserve my judgment for some time but it became apparent that they had been ignored . . . That's what built up this breach more than anything else.

At Mr. Wilkins' suggestion, all seven Directors met in September 1982 in a private home to discuss the problems of communications among the Board and what direction they should take in running the

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[27] Hearing Record, pp. 268–281.

SFC. A major topic at that gathering was the need for the Board or management to devise a strategic plan of operation. At the meeting, each Director indicated that he had a plan of operation for his own business and that, as Mr. Monks had pointed out, such a plan was especially crucial for a $20 billion publicly funded and accountable corporation, such as the SFC.

Despite this informal meeting aimed at ameliorating differences, disagreements and internal communications problems plagued the Board throughout the fall of 1982. While the lack of a strategic plan continued to be a major source of dissatisfaction, concern that the outside Directors were being excluded from management decisions also began to escalate. These factors led to the request by the outside Directors in November of 1982 that a communications plan for the Board be developed, delivered to, and discussed fully by the Board.

B. THE COUGHLAN REPORT

In December 1982, Mr. Schroeder directed Robert Coughlan, a consultant already under contract with the Corporation, to analyze the "formal and informal operating procedures and associated communications practices relating to interactions between and among the President, the Chairman, and other members of the Board of Directors of the Corporation."[28] Mr. Schroeder testified before the Subcommittee that the considerable conflict among the Board members was the impetus for the Coughlan assignment.

Mr. Coughlan interviewed the Directors and certain staff members, including Jimmie Bowden, the Executive Vice President, and Donald Thibeau, the Chairman's Executive Assistant, between December 7 and 22, 1982. His report to Mr. Schroeder, dated January 6, 1983, is entitled "Improvement of Corporate Communications."[29]

The major finding of the report is that the concerns the Directors expressed "reflect a serious communications void at the Board level, particularly between the 'outside' and 'inside' Directors, i.e., the Chairman and the President." Mr. Coughlan reported that the Directors expressed the following concerns most often during his interviews with them:

(1) Corporation management does not anticipate or follow through, but goes from one activity to the other.

(2) The Corporation needs more substance, less form; it is too structured, has too many people, and should have a stronger staff.

(3) The SFC is not effective in project development because the processes involved tend to break, rather than make, deals. The Corporation should consider projects that are weaker than desired, but which do have sufficient substance to merit risk.

(4) The Board must meet with sponsors and be thoroughly informed about projects before being asked to approve the recommendations of the Corporation staff.

(5) The Board must have more leadership from the Chairman and better responsiveness from the President.

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[28] Consulting Agreement Number SFC-82-043-A Between United States Synthetic Fuels Corporation and Robert E. Coughlan, Amendment No. 1.

[29] Hearing Record, pp. 183-194.

(6) The Board needs a better understanding of what is expected of its members and of the roles and responsibilities of the Chairman, President, and other members of the Corporation staff.

(7) The pressures on and the orientations of the Chairman and the President may require that they be provided with senior professional assistants able to initiate and manage special activities.

(8) As trustees, Board members intend to take very aggressive action in solving management and communications problems.

(9) Board meetings could be more effective if the closed meetings were held before the public meetings. Also, minutes of the Board meetings are too sanitized when released.

Other concerns expressed by the Directors included a feeling that the Corporation management does not communicate as openly with the Board as it should, a belief that industry should be better informed about the resoluteness of the Corporation to establish a national synfuels program, and criticism of the progress to date on the development of the Comprehensive Strategy.

While Mr. Coughlan found a "unity of purpose and commitment among all Directors insofar as attainment of the Corporation's objectives is concerned," he concluded that "what we have been communicating about ourselves as a Corporation unfortunately has not been readily accepted or clearly understood by even the constituencies on which we must depend for the accomplishment of our mission."

Noting that "much can be done rapidly to begin to improve the Corporation's internal and external communications process," Mr. Coughlan made three principal recommendations: a special, informal meeting of the Board of Directors should be convened; a Secretariat operation should be installed immediately as part of the Chairman's office; and a communications task force should be established.

1. Special Meeting of the Board

Mr. Coughlan recommended that an informal two-day meeting of all members of the Board be convened as soon as possible, preferably prior to the January 20, 1983, Board meeting, to address the following:

a. the development of statements of policy to document the resoluteness of purpose and the certainty of approach of the Corporation,

b. the preparation of instructions for use by the Corporation staff to make definite, detailed plans for the implementation of Board policies,

c. the specification of the approach to be used for the establishment of the Comprehensive Strategy,

d. the determination of responsibilities to be assumed by the Board for continuing review of program development and the Comprehensive Strategy, and

e. a frank, in-depth, and unstructured exchange of views concerning management matters, with attention also directed to any desired improvements in the relationship between the outside and inside Directors.

If for legal reasons this informal meeting could not be held, the report suggested that three temporary committees be established as an alternative.

2. Secretariat Installation

Mr. Coughlan's second recommendation was the immediate creation of a Secretariat within the Chairman's office to serve as the focal point for all official communications and to provide support to the Board of Directors. The Secretariat would ultimately be responsible for monitoring all scheduled activities, compiling and disseminating project review materials, and controlling the flow of all internal communications.

The Coughlan report also proposed that once the Secretariat became operational, the role of the Executive Assistant to the Chairman (Donald Thibeau) should be expanded to include monitoring all tasks assumed by the Chairman and the President and ensuring proper support from the Corporation staff.

3. Communications Task Force

Mr. Coughlan's third recommendation was that a formal communications program be developed as soon as possible and that, in the interim, a Communications Task Force be established for 90 days "for the purpose of addressing communications improvements that are urgently needed." Mr. Coughlan identified specific Board members and staff who should serve on the Task Force and its congressional, industry, administrative, financial, and media units.

The first Board meeting to occur after the submission of the Coughlan report was on January 20, 1983, in Houston, Texas. In response to a question from Senator Cohen at the July 27 hearing, Mr. Coughlan said that he was on "stand-by" at the January Board meeting but was never asked to present or discuss his report or any of his recommendations. The minutes of the January meeting indicate that there was no discussion of the Coughlan report during either the open or closed session.

During the closed session of the January meeting, Mr. Schroeder read a statement outlining his own approach to the communications problem.[30] Mr. Schroeder's communications plan, however, bore little resemblance to the findings and recommendations contained in the Coughlan report. The one parallel was that Mr. Schroeder, like Mr. Coughlan, proposed the installation of a Secretariat to facilitate communications.

The only other specific proposal Mr. Schroeder presented to the Board was the establishment of a Synthetic Fuels Information Clearinghouse to "identify the Corporation as the national focal point for information on synthetic fuels." The Clearinghouse, he explained, would be an "active, initiative-taking information facility."

To protest the management's failure to discuss the Coughlan report, Mr. Monks sent a memorandum to Mr. Schroeder on January 24 stating that the communications problems should be discussed at a meeting of the full Board, as recommended by the report. Mr. Monks continued in his memo:

> I really feel that Bob Coughlan's report arose out of concerns of the Directors, on which he had specifically focused for a substantial period of time. There is thus a kind of integrity in the questions expressed therein that should be dis-

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[30] Hearing Record, pp. 195–201.

> cussed. I do not think it appropriate simply to discredit Bob Coughlan's work.[21]

Mr. Monks further suggested that Mr. Schroeder's proposal for a Synthetic Fuels Information Clearinghouse "may . . . violate Section 171 of the Energy Security Act, in not being expressly authorized by the statute." Mr. Monks informed the Subcommittee staff that he never received a response to the concerns expressed in his January 24 memorandum.

At the July 27 hearing, Mr. Schroeder was questioned by Subcommittee members about why he did not follow Mr. Coughlan's chief recommendation that the Board have an informal, two-day meeting to resolve their differences. Mr. Schroeder testified: "I was opposed to it and had so stated to all the Directors. It's illegal." Senator Cohen asked him whether he thought that an informal get-together during which no business is discussed in terms of financial assistance contracts would be illegal. Mr. Schroeder replied that "to have all the Directors and officers together in any kind of affair that addressed any kind of communications effort would have constituted a meeting" and thus would be illegal under the Energy Security Act, according to the Corporation's counsel.

At the Subcommittee's July 29 hearing, however, four of the Directors testified that they had gotten together several times informally and privately, including as recently as when they were in Tulsa for the May 26 public meeting.

It is apparent that the rules pertaining to such gatherings were selectively enforced. Without passing judgment on the legality of these meetings, the Subcommittee also notes that Mr. Coughlan provided an alternative if the meeting could not be held.

Mr. Schroeder also testified that he took no action on Mr. Coughlan's recommendation that a communications task force be established for 90 days to address "communications improvements that are urgently needed." He justified his decision not to follow this recommendation by asserting "I have never hired a consultant to manage something for me nor have I ever hired a consultant with the idea in mind that I would use everything that he recommended."

The Subcommittee believes, however, that Mr. Coughlan's findings and recommendations should have been discussed fully at a meeting of the full Board and that all of the Directors should have been involved in evaluating his recommendations. Mr. Wilkins testified that the lack of action on the Coughlan report was a continuing source of frustration to him. A joint decision on whether or not to implement Mr. Coughlan's proposals would have produced more harmony in the Board's relationships and would have been most appropriate in light of the concerns the Directors had expressed.

The Subcommittee finds that the Coughlan report was never fully considered nor implemented. This indication exacerbated the friction among the Board members and was a missed opportunity to improve the communications of the Corporation.

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[21] Memorandum from Robert A. G. Monks to Victor A. Schroeder, dated January 24, 1983, entitled "Board Communications." Retained in Subcommittee files.

C. EVENTS SUBSEQUENT TO THE COUGHLAN REPORT

Disagreements concerning communication issues continued in the months following the Houston meeting. Discussion held at both public Board meetings and informal meetings of Directors indicated that some Board members were growing increasingly disenchanted with the management of the SFC.

At the March 24, 1983, Board meeting, Mr. Schroeder proposed a plan of reorganization for the Corporation. The proposal consisted of amending the Corporation's System of Organization and By-Laws in order to restate the functions of the Executive Vice President and Vice President-External Relations regarding industrial relations, and to establish the position of Vice President-Corporate within the SFC. Mr. Schroeder explained that these structural changes were designed to improve the overall communications problems experienced by the Board.

Mr. Monks presented the Compensation Committee's response to this plan.[32] He indicated that the Compensation Committee's recommendation was for the Board to take no action on the reorganization plan at that time because the new position of Vice President-Corporate had never been discussed by the Board as a whole. Following this recommendation, Mr. Monks expressed his individual objections to the plan on the grounds that the Board had never adequately analyzed its communications problems and that the Board, rather than solely Mr. Schroeder as Chief Operating Officer, should devise the proper solution to the problems. Mr. Monks stressed the need for the entire Board to clarify its own responsibilities and functions under the Energy Security Act and that this should be achieved prior to making structural changes in the SFC. In light of the objections raised at the meeting, the Board decided to defer action on the reorganization plan until a later Board meeting.

During the next three months, Messrs. Wilkins, Carter and Monks discussed alternatives on how to remedy the internal problems within the SFC Board. During this period, the three Directors' dissatisfaction centered around their belief that management excluded the outside Directors from decisionmaking, that management of the SFC was inadequate, and that immediate steps were necessary to clarify the respective responsibilities of management and outside Directors. In addition, the three Directors were concerned by allegations which had surfaced concerning a conversation between Mr. Schroeder and Mr. Masson on the evening before the March 24 Board meeting in New York City.

On several occasions, the outside Directors expressed their concerns to Chairman Noble. Mr. Wilkins, for example, testified that he approached the Chairman many times to explain his dissatisfaction with the management of the SFC, but that Mr. Noble took no action to address his criticisms. Mr. Monks also discussed his dissatisfaction both at Board meetings and with Chairman Noble and Mr. Schroeder.

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[32] Hearing Record at 284. The Compensation Committee is a standing committee which was created by resolution of the entire Board and whose functions include recommending salaries and benefits for SFC personnel. The Committee is chaired by Mr. Wilkins and also consists of Mr. Monks and Mr. Thompson.

In April, Mr. Wilkins and Mr. Carter met jointly with Chairman Noble to discuss their problems with the management. At that meeting, the two part-time Directors informed the Chairman that they were speaking on behalf of themselves and Mr. Monks, and that the three Directors believed that action was necessary to improve the Corporation's management. Mr. Wilkins testified that although the Chairman "was concerned about our concerns," he took no steps to remedy the problems.

By May 1983, the outside Directors had decided that stronger action was necessary to resolve the communications problems. On May 12, Directors Wilkins and Monks met with Mr. Noble to once again discuss their problems concerning the Board. At that meeting, the two Directors presented Mr. Noble with a letter bearing the initials of themselves and Mr. Carter, which outlined specific actions they wanted the Chairman to take.[33] The strongly worded letter acknowledged that the three Directors had already "on many occasions over the past six months, individually and jointly, privately and in open and closed meetings," discussed their concern over the management of the Corporation with Chairman Noble. The stated purpose of the letter was to make "unmistakably clear" the Directors' continued conviction that the Corporation's present management was impeding the Board in its attempts to discharge its duties under the Energy Security Act and their belief that the Corporation lacked an adequate system of organization to fix responsibility. The Directors also informed the Chairman of their conclusion that all Directors should be involved in the development of a new system of organization for the SFC. The letter then formally requested Mr. Noble, as the Chief Executive Officer of the Corporation, to take specific steps by prescribed dates to address the Directors' concerns.

First, the Directors asked the Chairman to investigate allegations surrounding a meeting which took place between Mr. Schroeder and Mr. Masson on March 23 and 24 in New York City. The Directors stated that at that meeting, "certain agreements were alleged to have been reached with respect to the exercise of their [Mr. Schroeder's and Mr. Masson's] respective fiduciary powers as Directors." The three Directors indicated that each of them had repeatedly conveyed their concerns over this meeting to Mr. Noble, and that rumors of the meeting were abounding both within and outside the Corporation. Specifically, the Directors requested the Chairman to provide the Board with his written conclusions of the investigation including his assessment of the propriety of the meeting and a summary of the actions he planned to take to resolve the matter. The Directors asked the Chairman to present his formal report to the Board on or before the May 26 Board meeting.

Second, the three Directors requested the Chairman to "make suitable arrangements for termination of the services" of Mr. Schroeder as the President of the SFC on or before the May 26 Board meeting. The Directors believed that this step was necessary to solve the "inside" versus "outside" problem within the Board and to restore confidence in the management of the SFC. Finally, the letter requested that the Chairman appoint a committee consisting of himself, Mr.

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[33] Hearing Record at 202.

Wilkins and Executive Vice President Jimmie Bowden to develop a new organizational plan for the Board's consideration and approval at the June 30 meeting.

In closing, the Directors stated that if the Chairman were unwilling to perform these functions, they wanted the three issues to be placed on the agenda for the public portion of the next scheduled meeting of the Board.

At the July 27 hearing, Subcommittee members questioned Mr. Noble about his reaction to the letter presented to him on May 12. Mr. Noble responded that when he received the letter from Mr. Wilkins and Mr. Monks, he questioned whether Mr. Carter had seen it since it bore only typed initials of the three Directors, rather than their handwritten initials or signatures. He indicated that "while he took everything in that letter very seriously," he was offended that a letter containing such serious charges was unsigned by its authors, especially one Director, Mr. Carter, who was absent from the May 12 meeting. He testified that because the letter was unsigned, he did not place it in the SFC files or give a copy of it to Mr. Schroeder. When asked directly whether he believed in May that the letter reflected the opinions of the three Directors, however, Mr. Noble testified that here was no question in his mind that it did reflect their views.

Testimony by Messrs. Wilkins, Carter and Monks confirmed that the May 12 letter did indeed reflect their views on both May 12 and the date of the hearing. Mr. Wilkins indicated that because the Directors had raised the matter verbally with the Chairman on a number of occasions without success, they felt that the next proper gradient of action was to put their requests in writing. He testified that the letter was intentionally unsigned, as the three Directors wanted to register their concerns without making them public or, in Mr. Wilkins' words, making a "Federal case" out of the Board's problems. Similarly, Mr. Carter testified that although he had not seen the actual letter, he had discussed its contents with Mr. Wilkins prior to the May 12 meeting and had given his approval to the recommendations contained in it. Mr. Carter testified that while the letter "might have been a little tough," he "certainly agreed with [its] conclusions." Finally, Mr. Monks informed the Subcommittee that he believed the letter to be an accurate statement of what needed to be done at the Synthetic Fuels Corporation.

At the hearing, Mr. Monks was asked what Mr. Noble's response to the letter was. Mr. Monks replied: "Mr. Noble was very angry. He said that we were trying to destroy the Corporation, that he would never do it, that it was an affront of unforgiveable proportions."

Equally strong evidence of serious problems within the Board occurred at the May 26, 1983, Board meeting in Tulsa, Oklahoma. Prior to that meeting, Chairman Noble had referred the allegations of the meeting between Mr. Schroeder and Mr. Masson to Inspector General S. Kenric Lessey for investigation. At the May 26 meeting, a resolution to amend the By-Laws and the System of Organization was presented to the Board. Despite these events concerning the issues raised in the May 12 letter, the outside Directors believed that insufficient action had been taken to address their requests to the Chairman. Mr. Wilkins testified, for example, that he believed that the

Board should fully consider the question of Mr. Schroeder's removal, as well as an organizational plan which would more completely address the problems the Directors had been experiencing with the management of the SEC.

Because the three Directors lacked sufficient votes to force discussion of these issues, prior to the meeting Messrs. Wilkins, Carter and Monks had agreed to register their dissent procedurally in an open Board meeting by abstaining from voting on some issues before the Board. The three Directors abstained from voting on resolutions to approve the minutes of the April 1983 meeting and to delete certain portions of the April 1983 closed Board meeting, both of which were routine, procedural votes.[34] Similarly, the three Directors abstained from voting on resolutions to amend the By-Laws and the System of Organization of the SFC to create a new Vice President-Corporate and to amend officer descriptions within the Corporation. On resolutions to approve the form of a lignite solicitation and to close the Board meeting to the public, Mr. Monks and Mr. Wilkins once again abstained from voting.

Mr. Wilkins explained at the Subcommittee's hearing why he abstained from voting:

> The concerns which I believed to be fundamental at that time had not been addressed for a number of months. I could no longer, in conscience, vote on any matters, substantive or procedural, without having these concerns addressed.

In light of this controversial action by the Directors at a public Board meeting, the Chairman suggested, in closed session, that the Board must talk frankly about the organization of the SFC, and an "urgent" discussion ensued.[35] Mr. Wilkins stated that the organizational plan of the SFC did not reflect the true division of authority within the Corporation, and he urged the Chairman to resolve this problem swiftly. Mr. Monks also spoke on the communications and organizational problems facing the Board, and offered his resignation to eliminate the problems, an offer which Chairman Noble refused. After extensive discussion, Mr. Carter recommended a temporary organizational change within the SFC to remedy some of the Board's problems. Under Mr. Carter's plan, Mr. Schroeder would retain the title of President, yet assume the title and functions of Vice Chairman of the Corporation. In addition, Mr. Bowden would retain his title of Executive Vice Chairman, yet function as the Chief Operating Officer of the Corporation. The Board unanimously approved this change as a compromise to address concerns of the part-time Directors, but agreed to make the change only temporary so that the Board could evaluate the effects of the reorganization after a period of 90 days.[36] At the July 29 hearing, Mr. Wilkins testified that the Tulsa Board meeting allowed the outside Board members to air and resolve some of their differences.

D. THE SUBCOMMITTEE'S REVIEW

The Subcommittee believes that the foregoing chronology of events present a compelling case that relationships and communications within the Board of Directors at the SFC have been severely troubled for over a year. The SFC management has, until very recently, failed to provide clear direction to the Board on the organization of and duties and responsibilities within the Corporation. The part-time Directors, despite extensive briefings and materials provided before open Board meetings, have not been adequately consulted or included in molding the decisions and direction of the Corporation. In short, the part-time Directors became concerned about the quality of communication, not the quantity, and about the extent of their participation in the decisions of the SFC.

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[34] See Hearing Record, pp. 314–343.
[35] Hearing Record at 340.
[36] Hearing Record, pp. 341–42.

Other factors served to exacerbate the problem. The close-knit relationship of the management, for example, had made the part-time Directors even more removed from the decision-making of the Corporation. Mr. Noble and Mr. Schroeder had a long-term business relationship prior to their positions on the SFC Board, and Mr. Schroeder's wife, Kathryn, was a long-time employee of the Chairman prior to coming to the SFC as Mr. Noble's Executive Secretary. Similarly, Charles Cowan, Sr. Vice President for Projects, was a former business associate of Mr. Schroeder, and some consultants hired by the SFC had close ties to the management, giving rise to suggestions of cronyism.

All of the part-time Directors who testified at the Subcommittee's hearing stated that such relationships have had an adverse effect on the structure of the SFC and contributed to the gap that existed between the management and the other Directors.

> Senator RUDMAN. Mr. Monks, I guess I am going to get down to a very basic question here . . . I would like to ask it of all four Directors. The testimony certainly comes across to me that this Corporation has been in somewhat a state of disarray in terms of its relationships, and that has had a direct effect on its accomplishment of its mission. We have a situation here that is unusual for Government. It may not be for private industry. The Chairman, Mr. Noble, a man of an excellent reputation, good background, his secretary happens to be the wife of a gentleman who is now the President of the Corporation, do you think that's a healthy situation in terms of outside, inside irrespective of what the statute says?
>
> * * * * *
>
> Mr. MONKS. I think its extremely regrettable in a public Corporation to arrange relationships so that there is a perception of inside and outside. I think that this attitude has permeated the Corporation to the extent there are two classes of people. There are classes of people who are family people and classes of people who are not family. The qualifications of family people for the offices they hold are not professionally competitive. The qualifications of nonfamily people for the offices they hold are professionally competitive. I think it's impossible to ask a responsible manager to try to run a business under those conditions.
>
> Senator RUDMAN. In this case, Mr. Schroeder has been a business associate many years ago, and a close friend of the Chairman, Mr. Noble, for many years. Mrs. Schroeder, prior

> to her marriage to Mr. Schroeder, has been a long-time employee of the Chairman, and these three people personally are very close; is that correct?
>
> Mr. **Monks.** That's my impression. Yes.
>
> Senator **Rudman.** Mr. Carter, generally, as to whether or not you think this had some effect on the whole management ladder.
>
> Mr. **Carter.** Yes, sir; I am sure it's had an effect.
>
> Senator **Rudman.** Mr. Masson?
>
> Mr. **Masson.** Yes, sir; and I have had a number of conversations prior, with Mr. Noble in regard to that.
>
> Senator **Rudman.** Mr. Wilkins?
>
> Mr. **Wilkins.** I do not differ from the other gentlemen, Senator.

Moreover, three of the part-time Directors believed that Mr. Schroeder lacked the necessary qualifications to serve as President of the SFC, yet their requests for consideration of this important matter were ignored by the Chairman of the SFC for some time.

The Subcommittee believes that these conditions existing within the Board, which were described by several Directors as "hypercontentious," have taken a toll on the performance of the Corporation. As several Subcommittee members pointed out, the Subcommittee is not concerned with mere personality conflicts within the Board. Such conflicts, as well as differences of opinion, may be inevitable, and even healthy, in a statutorily authorized Board composed of seven, independent minded individuals with diverse views and experiences. The fact that the U.S. President rather than the Board itself, chooses the Chairman, also makes conflicts more likely to occur at the SFC than in a private sector corporation. These differences of opinion are outside the proper oversight responsibilities of the Congress. Clearly within the concern and jurisdiction of the Congress and this Subcommittee, however, are conflicts within the Board which adversely affect the progress of the SFC in performing its functions under the Energy Security Act. The factors considered by the Subcommittee during its investigation and hearings, for example, the schism between the inside and outside Board members, the perception by outside Directors that they have been ignored by management, concerns by some Directors over the quality and activities of the management of the SFC, provide ample evidence that the communications and relationships within the Board had deteriorated to the point of jeopardizing the progress of the Board in fulfilling its statutory responsibilities.

Senator Levin questioned the part-time Directors about the impact of the conflict within the Board.

> Senator **Levin.** What difference does it make, in terms of serving the Corporation's activities, whether it's a hypercontentious Board or a smoothly functioning Board?
>
> Mr. **Wilkins.** I think there's a substantial difference in terms of how fast or how smoothly we can move.
>
> * * * * *
>
> Senator **Levin.** Mr. Masson, is this something we should worry about? We have got a hypercontentious Board, and we

> have got a divided Board that has got all these problems in communications gaps and conflict. Is that something we should worry about?
>
> Mr. MASSON. Senator, I would submit it to you that it should be something that you should be concerned and worried about, to the extent that it either has or may in the future prevent the Corporation from carrying out the mandates of the Energy Security Act. That is, in the final analysis, what the Corporation should be measured by.
>
> Senator LEVIN. Has all this contention made it less likely that we are going to reach the goals we have set for that Corporation?
>
> Mr. MASSON. Up until this point, I would have to say, no, sir.
>
> Senator LEVIN. Mr. Carter, has all this hypercontention had any impact on the work of this Corporation?
>
> Mr. CARTER. Yes, sir; it has to have some effect on it. There's no doubt about that. The management of this Corporation, Mr. Schroeder and Mr. Noble today, a group of very independent thinking people, I don't think they recognized it to the degree they should have at this time. I think the communications could have been much better. . . .
>
> Senator LEVIN. Thank you. Mr. Monks, does this hypercontention concern us? Does this affect the output of the Corporation?
>
> Mr. MONKS. Yes, and yes.

The preoccupation of the Directors with communications and internal problems has necessarily detracted from the Board's capacity to act cohesively and give full attention to substantive policy decisions. When such "hypercontentiousness" is evident to the public and industry, as it has been over the past year, it can adversely affect the relationship of the SFC with its constituents, and reduce its efficacy in the eyes of the public, whose dollars it is placing at risk.[37] These effects can directly undermine the success of the SFC in providing financial assistance to synthetic fuels projects, and, consequently, the development of a viable synthetic fuels industry in the United States.

The evidence suggests that communications within the Board have recently improved. For example, on July 20, Chairman Noble wrote to the Directors stating that his delegation of authority to the President for preparation of the Comprehensive Strategy had never been confirmed by the Board.[38] The question of who should prepare the Comprehensive Strategy had been raised by the outside Directors and had remained unresolved for almost six months. In his letter, the Chairman asked the Directors for their suggestions on options for the staff to examine in working on the Comprehensive Strategy and welcomed their suggestions on how the Board could best work with the staff on this report. Finally, at its August 29 Board meeting, the Board decided to abolish the position of the Vice President-Corporate and to designate Jimmie Bowden, the Executive Vice President, as Chief Operating Officer responsible for the overall management of the administrative and project-related operations of the Corporation. Acting at Mr. Noble's suggestion, the Board agreed to leave the position of President unfilled at this time and to determine during the next 60–90 days whether and by whom the position would be filled. Both of these issues had been strong points of controversy within the Board.

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[37] The Subcommittee found strong evidence indicating that the internal problems of the SFC have been evident to the public and industry. In "Project Indigo," an industry survey conducted by the SFC Office of Inspector General, submitted to the Board in April, 1983, some industry representatives commented on internal relationships within the SFC, and one sponsor stated that better communications between the Board and senior management was necessary. See Hearing Record, pp. 213–27. A report of the Senate Appropriations Committee also cited problems of communications within the Corporation. Id. at 181. Moreover, the disagreements within the Board concerning the organization of the Board and SFC have been aired in open Board meetings over the past six months.

[38] Hearing Record, pp. 228–29.

The Subcommittee views these recent events as encouraging signs of improvement within the Board, and hopes that the Board is now better equipped to turn its attention more fully to providing financial assistance to worthy synfuels projects. The Subcommittee believes, however, that certain actions are necessary to ensure continued and effective cooperation among the Directors.

First, the Subcommittee recommends that the Board of Directors collectively develop a strategic plan for accomplishing its duties under the Energy Security Act. In addition to stating the Board's objectives and priorities, the plan should specify the resources, personnel, and timetable for reaching the Corporation's investment objectives. Closely related to this plan is the need for the Board to clearly delineate the responsibilities and functions of the part-time Directors vis-a-vis the management of the Corporation. This should be set forth within the SFC's System of Organization, which is required by section 117 of the Energy Security Act.

The Subcommittee also recommends that the SFC Inspector General conduct a management audit focusing on the Corporation's organizational structure, internal controls, and planning. In considering the Corporation's organizational structure, the Inspector General should consider whether the SFC has too many officers and whether the lines of authority are clearly drawn. This audit should be prospective in nature and should provide specific recommendations for the Board of Directors and the SFC's new President to consider. The Subcommittee strongly believes that this audit must be conducted in-house by the Inspector General rather than contracted out to a consultant, as the nature of the issues studied require an extensive, on-going knowledge of the Corporation. In order to ensure ample time for the Board to make any necessary changes prior to the end of its first phase of operation, the Subcommittee recommends that the Inspector General complete this management audit within the next three months.

Finally, the Subcommittee commends Chairman Noble for his recent efforts to improve communications between the part-time Directors and management of the SFC and to encourage the active participation of part-time Directors. These actions by the Chairman better reflect the Congress' intent under the Energy Security Act to make all Directors active, involved, and responsible trustees of the Synthetic Fuels Corporation.

III. THE SFC's PROCUREMENT PRACTICES

A. THE CORPORATION'S PROCUREMENT POLICIES

Sections 175 (a) and (g) of the Energy Security Act effectively exempt the Synthetic Fuels Corporation from the Federal Property and Administrative Services Act which governs the procurement of goods and services by Federal civilian agencies and departments.

However, on October 28, 1981, the Board of Directors unanimously approved a statement entitled *Policy and Procedure for Administration of Contractual Arrangements*, which directs procurements to be made "in accordance with best commercial practice and generally consistent with Federal procurement policy." It further specifies that "contract awards should be based on competition whenever practical." [39]

To control the use of consultants, the policy statement lists several issues to be considered before a consultant contract may be let. These include:

1. the adequacy of objectives and methodology of the study for which the individual firm is to be engaged. The Corporation must have a specific and well-defined need for expertise not presently available within the Corporation and for which it is either infeasible or undesirable to add to the staff.
2. whether the consultation can and should be obtained at zero or reduced charge. Non-profit or professional organizations frequently provide services to public organizations on a no cost or low cost basis.

Each major consultant contact, aside from all other considerations, should be subjected to an analysis comparing its cost to the cost of developing an in-house capability.

3. the sensitivity of the subject and need to limit outsiders who will be given information.
4. the qualifications of the individual or firm with regard to the specific Corporation need. Previous experience with a particular consultant may be useful for evaluative purposes, but should not be the only basis for selection or a sole source award.
5. consideration of efforts elsewhere in the Corporation that may be related to the matter for which the individual or firm is being engaged. This would serve to prevent duplicative efforts as well as to suggest ways in which the task could be expanded to serve more than one purpose.
6. whether expertise is needed for general consultation rather than a specific task. If a task cannot be specifically defined, outside consultants should not be used. Rather, consideration should be given to hiring an individual expert as an employee of the Corporation. As an employee, the individual would be subject to appropriate restrictions in the areas of financial interests, conflict of interest, and safeguarding Corporation information.

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[39] Hearing Record, pp. 384–388.

Although Corporation officials issued several memoranda on contracting procedures during the months following the Board's adoption of the procurement policy statement, detailed implementing guidelines were not issued until the Corporation's Procurement Manual was published in November 1982. The Procurement Manual was developed primarily by Dwight Ink, the Vice President for Administration, and George Vecchietti, the Director of Contracts, after extensive consultation with potential users of the Manual. The 38-page notebook prescribes policies and procedures for the procurement of supplies and services by the Corporation and does not apply to financial assistance contracts.

The Procurement Manual includes sections on roles and responsibilities in the procurement process, source selection, conduct during competitive procurements, consulting agreements, contract administration, types of contracts, and simplified procedures for small purchases.

Supplementing the chapter of the Manual on consulting agreements is the "SFC Consulting Agreement Work Kit," which is used by any Corporation official who needs consulting services. The newest version of the kit, updated on July 6, 1983, contains the following forms: Request for Consulting Agreement; Statement of Need for Procurement; Up-front Disclosure Statement; and Conflicts of Interest Disclosure Statement.

B. PROBLEMS IN THE CORPORATION'S PROCUREMENT PRACTICES

The Corporation's procurement problems pre-date the confirmation of the current Board. Reports in the spring of 1981 by the House Committee on Government Operations and by the Corporation's Assistant to the Chairman for Inspections and Internal Audit identified substantial weaknesses in the SFC's contracting procedures. The reports criticized the Corporation for not awarding contracts on a competitive basis, for not maintaining adequate records, and for lacking uniformity in contract management.[40]

Despite the adoption of the procurement policy at the Board's October 1981 meeting, contracting problems persisted, as shown by a General Accounting Office report, internal audits, and other evidence.

1. GAO Report

The General Accounting Office reviewed 5 of the 11 professional service contracts that the SFC awarded between August and December of 1981 and found several deficiencies.[41] Significantly, the GAO's examination was limited to these five contracts because the Office of Administration did not have files on the remaining six at the time of the review. Documentation—to the extent it existed—was scattered among the users' office.

In each of the five contracts examined, the GAO found that information on one or more of the following items was missing: justification on the need for the contract; justification for the solicitation procedures used; justification for the time allowed for contractors to respond to solicitations, and the identity of the official who prepared and approved the contract. Only one of the five solicitations was publicly announced, and that solicitation limited competition by allowing only 13 days to respond to detailed requirements. The other four limited the number of firms requested to bid and/or the response time without providing adequate justification for these restrictions.

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[40] General Accounting Office, *Evaluation of Administrative Procedures at the Synthetic Fuels Corporation*, (GAO/RCED–83–27), October 18, 1982, pp. 7–8.

[41] Id., pp. 7–17.

One of the contracts reviewed by the GAO particularly demonstrates the extent of the abuses. On October 23, 1981, the Corporation signed a sole-source contract with Lloyd Bush and Associates for computer data processing. The contract records show that the $25,000 contract was actually signed after the work had been completed.

The GAO report, entitled *Evaluation of Administrative Procedures at the Synthetic Fuels Corporation* and published on October 18, 1982, concluded:

> Our review of selected professional service contracts awarded between August and December 1981 showed that the Corporation's Office of Administration did not provide adequate oversight of its professional services procurements from the initial planning and justification of the need for such services to the signing of the contracts.

The GAO noted, however, that there have been "some improvements in Corporation contracting practices since March 1982." The GAO found, for example, that the Office of Administration is maintaining a more comprehensive file on contracts than existed at the time of its audit.

2. Vice President for Administration Memorandum

Further evidence of the Corporation's 1981 contracting problems is found in a memorandum to Mr. Schroeder from Dwight Ink, the Vice President for Administration. The memorandum, dated July 30, 1982, states that the Corporation had the following procurement problems as of November 1981:

- The Corporation's "Policy and Procedure for Administration of Contractual Arrangements" was approved by the Board but had not been implemented.
- [The SFC] had no professional procurement (contracts) officer.
- Organizational roles and responsibilities were not clearly established.
- Contracting activities were being conducted in an uncontrolled manner.
- There was a high incidence of after the fact issuance of contracts, i.e., formalizing informal commitments where the "contractor" had already begun work.
- Style and substance of Requests for Proposals were of inadequate quality.
- Solicitations often did not afford potential proposers sufficient time to prepare proposals; this in turn led to unintended restriction of competition, and may have affected quality of proposals.

- Documentation of contractual activities was inadequate, unorganized, and decentralized. There were no "official contract files," and we did not know how many contracts existed.

Most of these problems, Mr. Ink noted, have been corrected, but other problems persisted into 1982.

3. The Inspector General Audit

In July of 1982, S. Kenric Lessey, the SFC Inspector General, directed his staff to undertake an audit of a sample of contracts to determine whether or not current SFC policies and procedures on awarding and monitoring contracts were effective.[42] His audit revealed material weaknesses in the contracting procedures. Specifically, the IG's audit found that:

- there was not always sufficient documentation to establish the need for the contract;
- in some cases, the basis for selection of a particular firm or consultant was not described in the request for the contract nor appropriately documented in the contract file;
- in most of the contract files examined by the IG, there was no monitoring report included; and
- there was no current requirement for an up-front disclosure statement by the SFC officer requesting the contract or by the Vice President of the unit to be supported by the contract. Such a statement would disclose any previous business or personal relationship between the SFC officer and the firm or individual consultant with whom the SFC plans to contract.

An example of a contract illustrating these deficiencies is a May 6, 1982, consulting contract awarded to Paul Phillips to advise the President of the SFC regarding the solicitation and evaluation of the synthetic fuels project proposals. Mr. Phillips was paid $600 per day. The IG found that there was no statement of need in the contract file, no statement regarding the basis for selection of Mr. Phillips, and no record of any monitoring of the contract.

The IG's report also criticized a May 1982 contract awarded to Korn/Ferry International in Washington, D.C., to undertake an executive search for candidates for the position of Vice President for Finance of the Corporation. The IG report states:

> Particularly in view of the currently depressed state of the U.S. economy, it would appear that SFC should not have given an exclusive contract to any one search firm and should not have agreed to the comparatively high fee of $26,000 which was payable in toto within 60 days from the date of the contract, whether or not a suitable candidate was identified by the search firm during that period of time. A billing arrangement more favorable to the Corporation should have been negotiated, and there is a discrepancy in the letter contract regarding the basis for the fee.

In a memorandum to the Board of Directors dated July 22, 1982, the Inspector General reported that "it is readily evident that there is insufficient and inadequate control within the Corporation" over certain aspects of contracting procedures. Mr. Lessey noted:

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[42] Memorandum from S. Kenric Lessey to Russell F. Miller, dated July 6, 1982, entitled "Audit Review of Contracts Executed to Date by the Synthetic Fuels Corporation." Retained in Subcommittee files.

> The hard questions are not being asked: Is this work really necessary? Is the contract absolutely essential to the mission of the Corporation under the Energy Security Act? Is this a wise and prudent use of taxpayers' monies? By working a little harder, could this job be done with in-house resources?

4. Subcommittee's Review of Consultant Contracts

The Subcommittee staff reviewed a dozen consultant files, as well as the Corporation's Procurement Manual, in order to determine if procedures implemented in 1982 had eliminated contracting abuses.

While the Corporation made significant progress in improving its contracting procedures during 1982, the Subcommittee found deficiencies in the SFC's evaluation and award of contracts to individual consultants.

The Corporation's Procurement Manual, issued in November 1982 and updated as needed, is a comprehensive document which, for the most part, contains sufficient safeguards to ensure good procurement practices. It precisely defines the roles and authorities of Corporation officials involved in the procurement process, establishes an absolute preference for the use of competitive procedures in the award of contracts (other than consultant agreements), provides detailed guidance on how competitions are to be conducted, and authorizes the use of Source Evaluation Boards to assess competitive proposals.

The effectiveness of the Manual is evidenced by the fact that, if one excludes consultant contracts, 96 per cent of the contract dollars the Corporation awarded in fiscal 1982 were awarded competitively. As of June 30, 1983, 82 per cent of the $1,813,598 in fiscal 1983 contracts—excluding consultant agreements—have been competitive.[43]

An example of a well-documented, competitive SFC procurement is the contract the Corporation awarded to American Security Bank to act as the trustee for the SFC's retirement and savings plan. A detailed Request for Proposals was issued to several banks and insurance companies, and a Source Evaluation Board assessed the responses. The contract file is complete and provides a full justification for the Corporation's source selection.

The Manual procedures for consulting contracts, however, need to be tightened in light of the SFC's exclusive use of sole-source contracts for and its over-reliance on outside consultants.

In fiscal 1982, the Corporation awarded 26 contracts to individual consultants totalling $276,615. Not one of these contracts was awarded competitively. As of June 30 of the current fiscal year, the SFC has awarded 25 individual consultant contracts totalling $346,850. Again, none has been awarded competitively.[44]

Unfortunately, the provisions of the Procurement Manual designed to accommodate legitimate sole-source contracts, e.g., when the Corporation needs a specific, nationally-known expert, are being cited to allow the routine award of sole-source contracts to individuals who do not have the unique experience that would justify a non-competitive award.

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[43] Hearing Record at 395.
[44] Id.

Two of the contracts reviewed by Subcommittee staff particularly illustrate this problem and indicate that the Procurement Manual has not eliminated abuses in the award of consultant contracts.

A former business associate of Mr. Schroeder, Eugene Rawls of Atlanta, Georgia, has been paid more than $100,000 in fees and expenses for interior design work that he has performed for the Corporation during the past two years. Mr. Rawls' first contract, awarded in May 1981, was "to assist in the design of the office space and supervise the move of Corporation headquarters" into the offices at 2121 K Street, N.W. There is no evidence in the contract files to indicate why Mr. Rawls was selected to perform this work. Interior design is not a unique service that would justify the award of a sole-source contract. This contract should have been awarded on the basis of competitive solicitation.

Mr. Rawls' May 1981 contract was extended several times, and he was awarded a second contract on March 14, 1983, to "produce basic drawings reflecting planned changes in the Corporation's space at 2121 K Street, N.W. . . . for Oliver T. Carr's review as required by the Corporation's lease." The justification in the contract file for awarding this sole-source contract was that Mr. Rawls was most familiar with the office space because of previous work for the Corporation. In effect, the first sole-source contract awarded to Mr. Rawls has locked the Corporation into doing business with him in the future.

Another sole-source procurement reviewed by the Subcommittee was a contract authorized by Mr. Schroeder for another former business associate, John Carbonell. The contract, which covered the period between January 3 and April 3, 1983, specifies that Mr. Carbonell would be compensated at the rate of $1,150 per week, plus reasonable travel expenses to and from Washington, D.C. and Atlanta, Georgia, plus a fixed sum of $6,000 for lodging, meals, and local transportation in Washington. A memorandum in the contract file notes that the Corporation staff located a short-term apartment "with kitchen facilities and appropriate ammenities" at a cost of $1,350 per month for Mr. Carbonell to use for the duration of his contract. The memorandum states that this arrangement would save money compared to the cost of the government-discount hotel rate. The files also indicate that Mr. Carbonell received a $3,000 advance for his expenses.

According to the contract files, Mr. Carbonell was hired to:

1. Prepare an outline, schedule, and presentation to appropriate publics of the Corporation's external communications plan.
2. Prepare a policy development outline and schedule, and necessary presentations activities.
3. [Perform] such other related activities as the President of the Corporation may require from time to time.

In justifying the basis for selecting Mr. Carbonell, Mr. Schroeder cited his prior experience with the consultant's work and Mr. Carbonell's nearly 20 years of corporate experience. The Subcommittee, however, found nothing in the contract files to indicate that Mr. Carbonell has extensive experience in the communications field that would justify the award of a sole-source contract. The SFC Procurement Manual states that previous experience with a particular consultant may be useful for evaluative purposes, but should not be the only basis for selection or a noncompetitive award. The Manual further specifies that "if there is or has been such previous experience, . . . the Corporation should assure that the basis for selection is qualification and merit."

At the Subcommittee's July 27 hearing, Senator Levin questioned Mr. Schroeder about the basis for selecting Mr. Carbonell.

> Senator LEVIN. I just want to ask you about the contract that was awarded sole source to a man named Mr. Carbonell in January 1983.
>
> Are you familiar with that contract?
>
> Mr. SCHROEDER. I am.
>
> Senator LEVIN. Was that awarded sole source, do you know?
>
> Mr. SCHROEDER. It was awarded sole source.
>
> * * * * *
>
> Senator LEVIN. Was it not practicable to have a competition for that contract that Mr. Carbonell was awarded?
>
> Mr. SCHROEDER. We did have competition because I thought of three or four people that could possibly do what we wanted done.
>
> Senator LEVIN. And solicited from all of them?
>
> Mr. SCHROEDER. No, nothing formal about it, a matter of sitting down at the desk and deciding who might do this, who knew the people in the Corporation, who knew the Directors, who was capable of assembling this information and making a recommendation.
>
> And Mr. Carbonell happened to be one of those individuals that was considered to do the job that Mr. Coughlan did. But Mr. Carbonell fell out of the informal thought process—competition, if you will.
>
> Senator LEVIN. I don't will it. If you "will" an informal thought process as competition, your definition of "competition" is a lot different from mine.
>
> Let me find out what it is. Are you saying that you thought about three or four potential contractors and decided in your own mind that Mr. Carbonell would be the best one?
>
> Mr. SCHROEDER. That is right.
>
> Senator LEVIN. That is what you call informal competition?
>
> Mr. SCHROEDER. That is right.
>
> Senator LEVIN. That is not what I call informal competition, to think about who could do it and then, without talking to anybody, decide, well, I am going to go with so and so and call that informal—informal or any other kind of competition.

The Subcommittee does not believe that the informal thought process described by Mr. Schroeder in any way approaches competition in awarding the Carbonell contract.

Equally troubling is that Mr. Carbonell's assignment appears to have overlapped with the contract of consultant Robert Coughlan who was studying the Corporation's communications at the same time that Mr. Schroeder authorized the contract for Mr. Carbonell's services. Both individuals focused on the Corporation's communications groups.

Mr. Carbonell's final work product consisted of a three-page outline of guidelines for a communications plan and a six-page outline entitled "Synthetic Fuels Corporation Interest Groups," which lists individuals and groups interested in synthetic fuels.[45] For example, the names of 17 Governors of states where synthetic fuels projects potentially may be located are listed. For his work for the Corporation, Mr. Carbonell was paid more than $21,000.

Nothing in the final work product submitted by Mr. Carbonell indicates that he was uniquely qualified to perform this task. In fact, it is unclear why this compilation could not have been performed by the existing staff of the Corporation.

The Subcommittee is concerned that the Corporation is contracting out functions that should be performed in-house, in violation of the SFC Procurement Manual and in contradiction to the sentiments expressed by the Board members during the October 1981 meeting.

The minutes of that meeting indicate considerable agreement among the Directors about the appropriate use of consultants.[46] Mr. Thompson stressed his belief that the SFC should not rely heavily on the services of outside consultants. Mr. Monks noted that the Corporation was committed to the development of an in-house capability to discharge its statutory functions with only a secondary and modest reliance on contracted services, and Chairman Noble said that the Corporation would use outside consultants "sparingly and only when necessary."

Page 22 of the SFC Manual states that prior to entering into a procurement agreement, it must be determined that the Corporation has a specific and well-defined need for expertise not presently available within the Corporation and for which it is either infeasible or undesirable to add to the staff. In view of this policy, the Subcommittee questions the Corporation's award of contracts to outside consultants to assist in the development and preparation of the recommended comprehensive strategy report to be submitted to Congress in 1984. The preparation of the Comprehensive Strategy Report is specifically assigned to the Corporation by Section 126 of the Energy Security Act. The report will be a significant factor in congressional deliberations on whether or not phase two of the Corporation's operations should be implemented. As such, it is a task which should represent the Corporation's own work and should not be the product of outside consultants.

C. THE SUBCOMMITTEE'S FINDINGS AND RECOMMENDATIONS

The Synthetic Fuels Corporation's procurement record is mixed. On the one hand, the SFC has made great progress by hiring highly qualified procurement officials, centralizing record-keeping, and increasing the use of competition for goods and services other than consultants. Overall, more than 80 percent of the Corporation's contract dollars were awarded competitively in fiscal 1982—a commendable record.

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[45] Carbonell, John, "Communications Plan Guidelines," and "Synthetic Fuels Corporation Interest Groups," dated March 18, 1983. Retained in Subcommittee files.

[46] Minutes of the October 28, 1981, meeting of the Board of Directors of the United States Synthetic Fuels Corporation, pp. 8–9.

By contrast, the Corporation's use of consultants continues to be characterized by abuses. All of the SFC contracts to individual consultants—totaling $623,465—were awarded sole-source between Octoreb 1981 and June 1983. In some of the contract files reviewed by the Subcommittee staff, the justification for the sole-source award was extremely weak; the scope of the consultant's work was not clearly defined, and the need for an outside consultant was not evident. The Subcommittee has concluded that some of the consultant contracts were not awarded solely on the basis of merit, but rather because the consultant was a former business acquaintance of an officer of the Corporation. While past business dealings should not be a disqualifying factor, in such cases the Corporation has an obligation to provide sufficient evidence to demonstrate that the selection of the contractor was not due to bias or favoritism. The SFC has failed to meet that test.

The Subcommittee rejects the reasoning of the Corporation's former President that subjecting consultant contracts to competition "makes no sense."[47] The Subcommittee's position is supported by numerous GAO reports, the Commission on Government Procurement, congressional hearings on the use of consultants, and the Office of Management and Budget's Circular No. A–120.

The General Accounting Office has issued more than 30 reports during the past 20 years, many of which have criticized federal agencies for failing to obtain adequate competition in awarding procurement contracts.[48] For example, a June 5, 1980, GAO report entitled *Government Earns Low Marks on Proper Use of Consultants* found that agencies reviewed did not obtain adequate competition for consulting services and lacked effective controls to minimize costs.

Similarly, the Commission on Government Procurement, in its December 1972 report to Congress, recommended that:

> the procurement of professional services should be accomplished, so far as practicable, by using *competitive* proposal and negotiation procedures which take into account the technical competence of the proposers, the proposed concept of the end product, and the estimated cost of the project, including fee. (Emphasis added.)

It is evident that competition in the award of some consultant contracts is not only feasible but desirable. The use of competition is, in fact, established policy for executive agencies and departments. On April 14, 1980, the Office of Management and Budget issued Circular A–120, "Guidelines for the Use of Consulting Services," which sets forth policies and procedures to control the use of consultants. Section 8(a)(3) of the Circular directs agencies to ensure that: "Contracts for consulting services are competitively awarded to the maximum extent practicable to insure that costs are reasonable."

Although the Synthetic Fuels Corporation is not bound by OMB Circulars, the Subcommittee believes that it should follow the OMB's policies on the procurement of consultant services. Mandating the use of competition where practicable would not preclude the award of legitimate sole-source contracts when the Corporation needs the services of a preeminent synfuels expert.

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[47] See Kurtz, Howard, "Synfuels President Under Fire," *The Washington Post*, August 9, 1983, at A5.

[48] General Accounting Office, *Government Earns Low Marks On Proper Use of Consultants*, (FPCD 80–48), June 5, 1980, at i. See, e.g., GAO reports B–14330, January 10, 1961; B–164031(4), August 31, 1973; B–114859, March 15, 1974; and EMD–80–2, November 2, 1979. The Subcommittee notes that every agency reviewed by the General Accounting Office had problems in managing consultant services.

The Subcommittee also finds that the Corporation contracts out for work that could or should be performed in-house. The Corporation has a highly paid and expert staff which should be able to provide many of the services for which individual consultants have been hired.

The Subcommittee recommends that the SFC Procurement Manual chapter on consulting agreements be revised to establish a policy of competition for consulting contracts to the maximum extent practicable. The Subcommittee recognizes that formal advertising would not be the appropriate procurement procedure for most consulting contracts because price alone is not the determining factor for source selection. However, the Subcommittee believes that competitive negotiation would permit the Corporation to determine which consultant could provide the best services, price and other factors considered.

The Subcommittee also recommends that SFC officials strictly adhere to the policies in the Procurement Manual. As long as the Manual is closely followed, the Corporation's contracting is likely to be highly competitive, well-documented and fully warranted.

IV. Conflict of Interest Issues

A. THE ALLEGATIONS OF AN IMPROPER AGREEMENT BETWEEN TWO DIRECTORS OF THE SFC

Of major concern to the Subcommittee during its investigation was a conversation that took place between two Directors of the Corporation, Victor Schroeder and Milton Masson, on the night of March 23, 1983. The Subcommittee received information suggesting that the two Directors may have reached an agreement to exchange favors and support for votes at a subsequent Board meeting. At the time of the hearings, allegations that such an agreement occurred were under investigation by the Inspector General of the SFC and were pending referral to the Department of Justice.[49] In order to examine the allegations, the Subcommittee subpoenaed Donald Thibeau, Executive Assistant to the Chairman of the Corporation, to testify on the conversation which he alone witnessed. In addition, Subcommittee members questioned both Victor Schroeder and Milton Masson extensively concerning the events which transpired on that evening.

At the hearing, the Subcommittee received conflicting testimony concerning the March 23 meeting.

1. Mr. Thibeau's Testimony

Donald Thibeau testified that the conversation between Mr. Masson and Mr. Schroeder occurred late in the evening of March 23 and early

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[49] On July 28, 1983, Inspector General S. Kenric Lessey, Jr., referred the allegations concerning the conversation between the two Directors to the Public Integrity Section of the Criminal Division of the Department of Justice, pursuant to 42 U.S.C. § 8718(b)(3). On August 18, Gerald E. McDowell, Chief of the Public Integrity Section, informed the Inspector General's counsel that the Department was closing its file on the matter after determining that there was "insufficient evidence of criminal conduct to justify further investigation or prosecution." (Letter retained in Subcommittee files.)

(Continued)

in the morning of March 24 in a hotel room in New York City. This room had been reserved for the use of the entire Board during their stay in New York City for the public Board meeting which was scheduled for the following day. According to Mr. Thibeau's testimony, only Messieurs Schroeder, Masson and Thibeau were present in the room at the time of the conversation. Mr. Thibeau testified that he was not a participant in the discussion, but rather his involvement was strictly limited to that of a bystander.

Mr. Thibeau testified that in their conversation Mr. Masson and Mr. Schroeder discussed a reorganization plan for the Corporation which was to be considered by the Board on the following day. He testified that Mr. Schroeder expressed his disappointment that a plan of reorganization for the Corporation, which Mr. Schroeder favored, had not been given a fair hearing by the other Directors. According to Mr. Thibeau, Mr. Schroeder asked Mr. Masson to support the reorganization proposal, which the two Directors discussed in detail. Senator Cohen addressed the following questions to Mr. Thibeau:

> Senator COHEN. Did Mr. Schroeder, during the course of that conversation, recommend that Masson should support him the next day in that vote?
>
> Mr. THIBEAU. He did.
>
> Senator COHEN. Did Mr. Masson indicate he would support the plan?
>
> Mr. THIBEAU. He did.

Mr. Thibeau further testified that the two Directors discussed the Big Horn Project, which would be considered by the Board at the meeting the next day. He stated that the SFC staff had recommended that Big Horn not be advanced in the Corporation's proceedings for consideration. In response to questioning by Senator Cohen, Mr. Thibeau described the Directors' comments concerning Big Horn:

> Mr. THIBEAU. Mr. Masson indicated that he had reviewed the staff recommendation for the Big Horn project. He indicated that he found fault with some of the staff recommendations and that he had various concerns about the staff recommendations that he wished to take up at the Board meeting the next day.

Mr. Thibeau testified that the Directors also discussed arrangements for Mr. Schroeder to contact Mobil Land Development Corporation on

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(Continued)

On August 23, 1983, the Office of Inspector General issued a report entitled "Inspector General Response to Allegations of Improper Conduct by Victor A. Schroeder and Milton M. Masson, Jr." In this report, the Inspector General issued his findings based on a thorough investigation of this matter by his office. The Inspector General concluded that, "While Mr. Schroeder's and Mr. Masson's conduct may indeed not have involved wrongdoing in the sense of violation of Federal criminal laws, it was certainly an indiscretion and may well have given rise to an appearance of wrongdoing which could cause a loss of important public confidence in the Corporation." The Inspector General further concluded that ". . . it was especially bad judgment for the Corporation's President—the senior management official of the Corporation—and another Director to allow the possibility of a perception that personal business interests were being mixed with decisions of the Corporation's policies. While Mr. Schroeder's and Mr. Masson's conduct may have been appropriate in the context of a private business organization, this conduct demonstrated at the very least an insensitivity of how public officials are viewed." Report pp. 3–4. As set forth later in this section, the Subcommittee concurs with and endorses the findings of the Inspector General concerning these allegations.

behalf of Mr. Masson. At the hearing, Mr. Thibeau recollected this conversation as follows:

> Mr. Thibeau. Mr. Masson's request to Mr. Schroeder was that Mr. Schroeder intercede with acquaintances of his in the Mobil Land Development Corp. to secure more information about projects that corporation was considering. He specifically asked Mr. Schroeder to help him identify particular projects and particular personnel within the Mobil Land Development Corp. that might be in a position to further develop the information that Mr. Masson was in need of for his business.
>
> Senator Cohen. Mr. Thibeau, was it your impression that evening that a deal had been struck or made between the two men?
>
> Mr. Thibeau. Senator, it was my impression that Mr. Schroeder and Mr. Masson came to an understanding. How you would characterize that understanding. . . .
>
> * * * * *
>
> Senator Cohen. When you say they came to an understanding, in your judgment, the understanding was that Mr. Masson would support Mr. Schroeder's proposal the next day, and, in return, Mr. Schroeder was going to make a phone call or calls on behalf of Mr. Masson; isn't that what you mean by understanding?
>
> Mr. Thibeau. Yes, Senator.

Throughout his testimony, Mr. Thibeau stressed his view that the two Directors had come to an "understanding" that Mr. Masson would support Mr. Schroeder's plan and that Mr. Schroeder would make a phone call on behalf of Mr. Masson. He was, however, very careful in how he characterized the conversation and stressed that the judgment of the understanding, "be it right, wrong, terrible, indifferent," should be left to others in positions of responsibility. Upon intensive questioning by Senator Levin, however, Mr. Thibeau did testify that, in his opinion, Mr. Masson's statement to support Mr. Schroeder on his reorganization plan and Mr. Schroeder's commitment to call his friend at Mobil Land Development Corporation were actually conditional upon each other, in other words, a quid pro quo:

> Senator Levin. . . . Not judging the ethics; I am simply saying there's a difference between two different kinds of conversation. One is, I will do something if you will do something. The other conversation is, I need your help on something, and you give an answer to that question, yes or no. And then you say, by the way, I need your help on something. And I give you an answer, not connected, not related, except in time; not conditional, one upon the other, necessarily, but happening in the same conversation.
>
> Now, without judging the ethics of either, by the way, they are different. Which was it?
>
> Mr. Thibeau. I think that anyone in the room would have come to the perception that it was more the former than the latter.

> Senator LEVIN. That they were conditioned upon each other?
>
> Mr. THIBEAU. Yes.

2. *Messieurs Schroeder's and Masson's Testimony*

Victor Schroeder and Milton Masson were also questioned extensively at the hearings about their March 23 conversation. Both Directors testified that they discussed the reorganization plan for the SFC. Mr. Schroeder, for example, responded to Senator Rudman's questions concerning the reorganization plan:

> Senator RUDMAN. What did you tell Mr. Masson concerning the plan, just generally? I assume you were soliciting his support for that plan.
>
> Mr. SCHROEDER. I told him what the plan was and what the job was to have accomplished. He asked if I wanted his support and I told him yes.
>
> Senator RUDMAN. Did you discuss the vote that would take place on that issue the following day?
>
> Mr. SCHROEDER. Yes.
>
> Senator RUDMAN. You encouraged him to vote with you on that issue?
>
> Mr. SCHROEDER. Right.

Both Mr. Schroeder and Mr. Masson testified that they discussed the Big Horn Project. Mr. Schroeder testified that Mr. Masson did not say he favored the project, but rather questioned whether the Board was giving small companies such as the Big Horn Company a fair chance to compete in the solicitation process. Mr. Masson also testified that he discussed with Mr. Schroeder his concern that small projects—basically those under $12 million in size—were being summarily dismissed by the Board because of their size. Both Directors testified that this discussion of small projects was precipitated by a letter each Director had received that day from one of the sponsors of the Big Horn Project asking the Board to consider the project further. Mr. Masson testified that he had not been familiar with the Big Horn Project prior to receiving the letter.

The Subcommittee received conflicting testimony from the two Directors concerning Mr. Schroeder's telephone call to Mobil Land Development Corporation. The following excerpts from the hearing transcript illustrate how the two Directors differed in their recollections of this conversation. First, Mr. Schroeder's testimony:

> Senator RUDMAN. . . . Now Mr. Masson is in the engineering construction business.
>
> Mr. SCHROEDER. Yes, I don't think he's in the construction business.
>
> Senator RUDMAN. Engineering design business. And he asked you to help him. Now we're not talking in your capacity as President of Synthetic Fuels but as an individual, to intercede in his behalf with Mobil to do something, did he not?
>
> Mr. SCHROEDER. He asked me if I knew anybody with Mobil Land and I told him that I did.

> **Senator RUDMAN.** Then what did he ask?
>
> **Mr. SCHROEDER.** He asked me if I could find out if they had any work in his area of the country that he could bid on, and I told him that I would, but I'm not certain that came up that evening. It may have.
>
> **Senator RUDMAN.** We will probably have testimony here that it did, so that's going to be someone else's recollection. Did you make the call?
>
> **Mr. SCHROEDER.** Yes, sir.
>
> **Senator RUDMAN.** Who did you call?
>
> **Mr. SCHROEDER.** I called Harold Singleton, a man who has worked for me about five times since the early '50s and he's in charge of Mobil Land Developments' projects in the Palm Beach area.
>
> **Senator RUDMAN.** Could you just give us the essence of that conversation?
>
> **Mr. SCHROEDER.** I just said to him, "Harold, could you tell me who's in charge of Mobil Land Development's work on the West Coast?" He said, "I can't tell you right now, but I can look it up and I'll call you back." So he did and he gave me a man's name in San Francisco. I think Harold wrote the man in San Francisco and said that I was a friend of his, and I was interested on behalf of another friend in any work that this man might bid on in the West.
>
> The man wrote me back from San Francisco saying that he had no work now in Arizona, but if he had some, he'd keep Mr. Masson's name in his file.

Mr. Masson recalled a different purpose for the telephone call to Mobil Land Development Corporation than that given by Mr. Schroeder:

> **Mr. MASSON.** . . . I did indeed ask that Vic Schroeder—not at the first time at the meeting, by the way, but at a previous occasion; possibly it was a previous Board meeting or some other time—if he in fact knew anyone at Mobil Land Corporation because I had heard that they bought approximately 2000 acres of raw land in the desert near Phoenix, Arizona. I would like to confirm that. He said earlier as a matter of fact, I have a personal friend of long standing who is in charge of Mobil Land Development. I said, great, would you call him or put me in touch with him, because I would like to know. The night of our meeting I very clearly reminded Vic. I said, "Vic, by the way, would you please follow through and call the guy and see if they have land in Arizona?"
>
> Subsequent to that, at some time, two or three weeks later, he wrote me a memo, indicating that here's a man's name of Mobil Land; he is expecting your call: can you call him and ask him. Since that time I have not had either the time or the interest to follow through: this has been several months, and it has not, quite frankly, gentlemen, been a high priority on my list, certainly not high enough to make a deal or to deal my vote. I think it is harmful to my integrity to even insinuate I would so something like that!

Later in the hearing, Senator Rudman asked Mr. Masson to explain the discrepancies between his testimony and that of Mr. Schroeder concerning the purpose of the call to Mobil Land Development Corporation. Senator Rudman pointed out that Mr. Schroeder had said the purpose of the call was to inquire whether Mobil Land had any work in Arizona on which Mr. Masson could bid. Mr. Masson testified that he did not even know that Mobil Land Development had projects. Rather, he said that he had heard that Mobil Land had purchased 2,000 acres but was not able to confirm that fact in Phoenix. He stated that he believed Mobil Land is in the business of buying and trading off land to developers, and that he had no particular interest in that type of project. Senator Rudman then asked Mr. Masson:

> Senator RUDMAN. You are telling us that Mr. Schroeder's recollection of the incident is incorrect, that in no way were you asking him to ascertain whether or not Mobil Land had any work that your engineering firm could bid on?
>
> Mr. MASON. No, sir.

Mr. Masson told the Subcommittee that Mr. Schroeder wrote him a memo two or three weeks later indicating that there was a man at Mobil Land who was expecting Mr. Masson's call. When Senator Levin asked Mr. Masson to provide this memo to the Subcommittee, however, he indicated that he could not find it but he was "sure Mr. Schroeder will have it." Subsequent to the hearing, the Synthetic Fuels Corporation informed Senator Levin that this memorandum could not be located within the SFC or Mr. Schroeder's files.[50]

Both Directors told the Subcommittee that the conversations concerning the reorganization plan and call to Mobil Land Development Company were not related. Mr. Schroeder testified that he was not certain it came up that evening. Mr. Masson told the Subcommittee that he and Mr. Schroeder had finished their conversation concerning the reorganization plan before discussing the call to Mobil.

3. Events Following the March 23 Conversation

Of equal concern to the Subcommittee was the Corporation's response to the allegations. According to Mr. Thibeau's testimony, he attempted to contact Chairman Noble concerning the conversation "as soon as possible" after the Board meeting. Because he was unable to reach Mr. Noble, he described the matter and his concerns with Mr. Wilkins on March 25. Mr. Wilkins advised Mr. Thibeau to "immediately return to Washington and bring the matter to the attention of the Chairman."

Mr. Thibeau testified that he informed Chairman Noble of the incident on March 30, 1983. Mr. Thibeau described Chairman Noble's reaction to this information:

> The Chairman listened carefully. He asked several questions, then advised me to take no further action, and that he would follow the matter.

Upon advice of the Chairman, Mr. Thibeau took no further action, but discussed the matter with other members of the Board only when they initiated conversations about the incident. This included Mr. Monks, Mr. Wilkins and Mr. Carter.

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[50] See hearing record at 204.

The hearing revealed that Messieurs Wilkins, Monks and Carter had significant concerns regarding the March 23 conversation and took action to have it resolved. Mr. Wilkins testified that he had raised this matter verbally with the Chairman on several occasions. Because he and the other Directors wanted the matter resolved, he and Mr. Monks delivered a letter to the Chairman, which bore the initials of three Directors, on May 12.[51] The letter formally requested the Chairman to "provide the Board with a written report of your conclusions as to what took place at this meeting, the propriety of the meeting . . . together with a summary of the actions that you propose to take with respect thereto." The letter also informed the Chairman that, in the Directors' opinions, "The Corporation has waited over long to take appropriate curative action." At the hearing, all three of these Directors testified that the letter adequately reflected what they thought should be done at the SFC.

Mr. Noble was also questioned by the Subcommittee on the sequence of events following the conversation in New York City. Mr. Noble described his actions concerning the incident to the Subcommittee:

> Mr. Noble. . . . Senator, I looked into it. I told him [Mr. Thibeau] at the time, and I knew something about the two propositions, when I looked into it. I found, number one, that the question of the Big Horn matter, everyone voted exactly the same and, number two, the issue that Mr. Schroeder was interested in, selling his views on the reorganization plan, that the matter was deferred to the next meeting.
>
> So when I looked at those two votes, I thought that was the case before I looked it up, but I felt there couldn't be much vote trading in that kind of situation, so I didn't give it further thought, until two Directors said directly that they questioned whether or not there was some sort of vote trading or something not representative of what we would want in the Corporation. I thought about that overnight, and I decided personally—I guess we met on Friday, this was Thursday, and I got back to Washington on Monday. I had already made up my own mind that I would turn this over to the IG because I felt that I had made a personal judgment.
>
> Senator Cohen. When was that judgment made, sir?
>
> Mr. Noble. It was right after I returned. As soon as I returned, I made the judgment that I was going to turn it over to the IG. I discussed it with the two Directors, but I had already made the judgment. And I want to say on their behalf that they insisted that it be turned over to the IG, both to protect the integrity of the process and the Corporation and their own integrity. . .

Although Mr. Noble had been given detailed information on March 30 about the conversation between the two Directors, he did not refer the matter to the Inspector General for investigation until May 17.

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[51] Hearing record at 202.

After several weeks of fact-finding and analysis, the Inspector General referred the matter to the Department of Justice on July 28. The Inspector General took this action pursuant to subsection 122(b)(3) of the Energy Security Act which requires that:

> The Inspector General shall report expeditiously to the Attorney General whenever he has reasonable grounds to believe there has been a violation of Federal criminal law.

Upon referral, the Department of Justice investigated the allegations concerning the March 23 meeting. On August 18, 1983, Gerald E. McDowell, Chief of the Public Integrity Section of the Department of Justice, wrote the following in his letter to the Inspector General's counsel:

> By your letter of July 28, 1983, written on behalf of the Inspector General for the United States Synthetic Fuels Corporation, you referred to the Public Integrity Section a matter involving possible violations of federal criminal laws by two Directors of the United States Synthetic Fuels Corporation.
>
> After careful review of the material provided by you and Russell Miller of the Inspector General's office, we have determined that there is insufficient evidence of criminal conduct to justify further investigation or prosecution. Accordingly, we are closing our file on this matter.[52]

4. The Subcommittee's Review

The Subcommittee agrees with at least three of the Board of Directors that, due to the gravity of the allegations surrounding the March 23 incident, this matter warranted a full and thorough investigation. While the Department of Justice has concluded that insufficient evidence exists to warrant further investigation or prosecution for criminal violations, the Subcommittee believes that this conversation, nevertheless, raises serious ethical concerns.

Of prime concern to the Subcommittee is the two Directors' apparent lack of sensitivity to the appearance of impropriety. Mr. Schroeder's responses to Senator Rudman's questions regarding the propriety of such a conversation, for example, suggest that he is insufficiently attuned to ethical considerations.

> Senator RUDMAN. . . . But in retrospect, Mr. Schroeder, do you think that if other Board members come to you and ask you to make calls on behalf of their private businesses, that that's a good idea?
>
> Mr. SCHROEDER. I think it's perfectly logical for us to discuss other people's business in a context. I wasn't on duty.
>
> Senator RUDMAN. You're not on duty Mr. Schroeder, but you are the President of the United States Synthetic Fuels Corporation, to use Mr. Noble's expression, one of the largest, giant—I think that's his word—venture capital investment banking houses in the country. You are, are you not?
>
> Mr. SCHROEDER. I agree.

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[52] Retained in Subcommittee files.

Senator RUDMAN. And you are 24 hours a day.

Mr. SCHROEDER. I agree.

Senator RUDMAN. And when you call someone at 3 o'clock in the morning or 2 in the afternoon or at midnight, when they talk to Vic Schroeder whom they respect and know, they're talking to Vic Schroeder, a friend who happens to be the President of the United States Synthetic Fuels Corporation, is that correct?

Mr. SCHROEDER. No.

Senator RUDMAN. You don't think so.

Mr. SCHROEDER. I've talked to a lot of people who don't look at me as the President of the United States Synthetic Fuels Corporation. Harold Singleton's one of them. I've known him since he was a 21-year-old man, and as I stated, he's worked for me several times, so this is a professional and personal relationship and has nothing whatsoever to do with the Presidency.

The Subcommittee rejects Mr. Schroeder's distinction between "on duty" and "off duty" conduct of officials of the Synthetic Fuels Corporation. Directors and officials of the SFC, as a federally chartered and funded Corporation, are public trustees and, as such, must adhere to the high standards of fiduciaries. These standards should govern their behavior whenever it could reflect on the SFC. As public officials, these persons must scrupulously avoid not only actual, but also the *appearance* of, impropriety. While it is often difficult for individuals who are new to government to adjust to this higher standard of behavior, the Subcommittee believes that high ethical conduct of all government officials, including those in quasi-government agencies like the SFC, is crucial to public confidence in government.

In its Policy on Standards of Conduct, which was adopted by a resolution of the Board on June 17, 1982, the SFC acknowledges that high standards of conduct must govern the Directors and employees of the Corporation.[58] Part 2, section 7 of the Policy states that:

> It is the policy of the Corporation not to interfere in the private lives of its Directors and employees. However, in view of the public trust confided to the Corporation by the Energy Security Act, certain standards of conduct, some of which are statutory, are required to assure the proper performance of the Corporation's business and the maintenance of public confidence in the Corporation. . . .

Thus, the SFC Board of Directors itself has recognized that its own Directors, officers and employees must adhere to high standards of conduct. The Policy expressly states that its purpose is to "assure that the business of the United States Synthetic Fuels Corporation is conducted effectively, objectively, and without improper influence or the *appearance thereof*." (Emphasis added.)

Section 8 of the Corporation's Policy specifically recognizes that acceptance or solicitation of gifts, favors, or gratuities can, at times, give rise to the appearance of impropriety or affect the objective judgment of the Director or employee of the Corporation. Section 8 provides that:

> Section 8. *Gifts, Gratuities, Entertainment and Favors.*
>
> (a) Acceptance of gifts, gratuities, entertainment and favors from those who have or seek business with the Corporation may be a source of embarrassment to both the Corporation and the Director or Employee involved, and may affect or appear to affect the objective judgment of the recipient, and may impair public confidence in the integrity of the Corporation's Business relationships. Therefore, except as provided in subsection (b) of this section, no Director or Employee shall knowingly solicit or accept, directly or indirectly, any gift, gratuity, favor, entertainment, loan or any other thing of monetary value, from any participating organization or any person who (1) has, or is seeking to obtain, contractual, or other business or financial relations with the Corporation; or (2) has interests that may be substantially affected by the performance or nonperformance of the Director's or Employee's official duty.

The Subcommittee finds that the agreement to have Mr. Schroeder contact Mobil Land Development Corporation on behalf of Mr. Masson may violate the spirit, if not the letter, of this SFC policy.

The Subcommittee recommends that the Board of Directors establish disciplinary procedures for violations of the Corporation's ethical standards. Whenever appropriate, the Ethics Officer and/or the Inspector General should recommend to the Board disciplinary sanctions for ethical violations which may not warrant referral to the Department of Justice but are contrary to established SFC standards of conduct.

The Subcommittee also concludes that the Chairman did not act swiftly enough to resolve the allegations concerning the March 23 meeting between Mr. Schroeder and Mr. Masson. Although Mr. Noble did review the minutes of the Board meetings to determine how the issues discussed by the two Directors had been resolved, he did not refer the matter to the Inspector General for investigation until May 17, well over a month after first hearing the allegation.[54] The Subcommittee is also concerned that a formal referral of the matter to the Inspector General was made only after three Directors formally put the Chairman on notice, through their hand-delivered letter of May 12, of their demands for investigation of the matter. Mr. Wilkins testified, for example, that they had discussed this matter on prior occasions with Mr. Noble without success.

The Subcommittee concludes that the grave nature of the allegations warranted immediate referral to the Office of Inspector General, which was specifically provided by the Congress to investigate and monitor the activities of the Corporation. The Subcommittee further finds that the Chairman should, whenever information suggesting improper conduct by a Director, officer, or employee of the SFC comes to his attention, immediately act to resolve the matter. In the case of possible criminal activity, the allegation should be referred to the Office of Inspector General for preliminary investigation. Similarly, infor-

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[53] See hearing record, pp. 400–24.

[54] See, "Inspector General Response to Allegations of Improper Conduct by Victor A. Schroeder and Milton M. Masson, Jr.," Office of Inspector General, United States Synthetic Fuels Corporation, August 23, 1983. Retained in Subcommitee files.

mation, evidence, or suggestions of improper or unethical conduct should be referred to the Designated Ethics Officer of the SFC. Referral to the Ethics Officer in such matters is required by section 8 of the SFC's Policy on Standards of Conduct which states that "any complaints from any source concerning the subject matter of this policy, whether emanating from within or outside the Corporation, are to be submitted to the Ethics Officer." The Subcommittee urges the Inspector General and the ethics officer to work closely together to investigate any such referral and to determine whether improper conduct has occurred. Swift, coordinated action in such matters will avoid the appearance of impropriety and thus enhance public confidence in the integrity of the Corporation as a whole.

Finally, the Subcommittee recommends that the Energy Security Act be amended to ensure that SFC Directors and personnel adhere to standards of conduct. First, the Subcommittee found that ambiguity exists over whether the criminal conflict-of-interest statutes extend to Directors, officers, and employees of the SFC.[55] Section 117(c) of the Act states that "except as specifically provided herein, Directors, officers, and employees of the Corporation shall not be subject to any law of the United States relating to governmental employment." While the Act expressly provides that the financial disclosure provisions and certain sections of the post-government employment restrictions of the Ethics in Government Act of 1978 apply to individuals within the Corporation, the Act does not extend the prohibitions against bribery in 18 U.S.C. 201, or the prohibitions against the receipt of compensation from non-government sources for performing one's official duties, as contained in 18 U.S.C. 209, to the Directors, officers, or employees of the Corporation. While the Subcommittee believes that the Congress did not intend to exempt SFC personnel from the scope of these important safeguards against criminal activity by public officials, the Congress should amend the Energy Security Act to expressly state that SFC Directors, officers, and personnel are subject to all criminal conflict-of-interest laws which now apply to Executive Branch personnel.

Second, the Subcommittee believes that the Energy Security Act should be amended to state that Executive Order 11222, Prescribing Standards of Ethical Conduct for Government Officers and Employees,[56] and its successors, are applicable to full-time Directors, officers, and employees of the SFC. While the SFC's Policy on Standards of Conduct, which is modeled after the standards of conduct regulations of several government agencies, thoroughly establishes standards of conduct for SFC Directors and personnel, the Subcommittee believes that, in some areas, additional enforcement mechanisms are required. Applying the Executive Order to full-time personnel of the Corporation will ensure that these standards of conduct carry the full force of law for any violations thereof. Similarly, the Subcommittee recommends that government-wide regulations implementing the Executive Order should be applied to full-time SFC employees.[57]

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[55] In his August 23, 1983, report on the allegations concerning Mr. Schroeder and Mr. Masson, for example, the SFC Inspector General concluded that "even the applicability of certain Federal criminal laws to officers and Directors of the Corporation was far from clear." Id. at 3. Similarly, conversations between the Inspector General's counsel and the Office of Legal Counsel of the Department of Justice indicated that it is not clear whether the criminal conflict-of-interest laws apply to SFC Directors and officers. Id.

[56] Executive Order 11222, "Prescribing Standards of Ethical Conduct for Government Officers and Employees," May 8, 1965, 3 CFR, 1964–1965 Comp., p. 306.

B. FINANCIAL INTERESTS OF THE DIRECTORS

Criticisms have been leveled against the present Board on the grounds that some of the Directors have personal financial holdings in energy or energy-related concerns. Critics challenge that such personal holdings can create conflicts of interest, as Directors could be in positions to affect the value of these interests through their votes or through their influence on the Board. Similarly, the potential exists that they could use inside information in trading on these interests.

In the course of its investigation, the Subcommittee assessed these concerns and the adequacy of safeguards against conflicts of interest.

1. Statutory Safeguards

- Financial Disclosure

The Energy Security Act provides two mechanisms to safeguard against conflicts of interest by SFC Directors. First, Subsection 118(a) extends the financial disclosure provisions of the Ethics in Government Act of 1978 to Directors and officers of the SFC. Because the Ethics Act requires all Presidential appointees who are subject to Senate confirmation to file public financial disclosure statements, each Board member, whether full-time or part-time, must submit a public financial disclosure statement prior to his or her Senate confirmation.[58] This disclosure statement lists by categories all sources of income and all financial holdings which the Director, his or her spouse, and dependents received or held during the preceding year, as well as any sales or exchanges of interests which occurred throughout the past year. These dislosure forms, pursuant to the Ethics Act and Office of Government Ethics regulations, are reviewed by the Ethics Officer of the SFC and the Director of the Office of Government Ethics to determine whether any actual or potential conflicts of interest are revealed by the nominee's disclosure statement.[59] The Director of OGE must then certify to the Senate confirmation committee that he has approved the statement as signifying that the nominee has or will take steps to remedy conflicts of interest.

Because section 118(a) of the Energy Security Act states that the financial disclosure provisions of the Ethics Act shall apply to the Corporation "as if it were a Federal agency," full-time Board members, as well as any part-time Board member who devotes time equivalent to 60 working days to the SFC in one year, must file annual disclosure statements.

- Recusal

Subsection 118(c) of the Energy Security Act establishes a recusal requirement for Board members. It provides that:

> No director shall vote on any matter respecting any application, contract, claim, or other particular matter pending be-

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[57] See, e.g., 5 CFR Part 735.101 *et seq.*
[58] 5 U.S.C. app. § 201; 5 CFR part 734.201.
[59] See, 5 U.S.C. § 206; 5 CFR part 734.604.

> fore the Corporation, in which, to his or her knowledge, he or she, his or her spouse, minor child, partner, or an organization (other than the Corporation) in which he or she is serving as an officer, director, trustee, partner, or employee, or any person or organization with whom he or she is negotiating or has any arrangement concerning prospective employment, has a financial interest.

The statute clearly states that violation of this recusal requirement is grounds for removal of the Director by the President of the United States.

The Act specifically provides, however, a mechanism for the Board to waive the recusal requirement in cases where a Director's financial interest would not create a conflict of interest. The Act provides that a Director may participate in matters in which he or she has an interest if the Director discloses the interest to the Board and if the Board determines that the interest is "too remote or too inconsequential to affect the integrity of such Director's services for the Corporation in that matter."[60] The Act specifies that the Director affected is not permitted to vote on this waiver of the recusal requirements.

The legislative history of the Act suggests that the Congress intended the SFC to be comprised of Directors with extensive experience.[61] Such qualifications are crucial to ensure sound investment decisions by the SFC. Although not expressly set forth in the legislative history, it is consistent with the goals of the Act to expect that some Board members could have backgrounds in, or relationships with, energy-related fields. By allowing the Board to waive the recusal requirement, the statute permits persons with some energy interests to serve on the Board, yet anticipates recusal whenever a matter before the Board directly relates to his or her financial holdings.

2. SFC Procedures to Implement the Act

The Subcommittee's review concluded that the SFC has acted diligently to implement the conflict-of-interest provisions of the Act. The financial disclosure and recusal provisions are administered by the Corporation's ethics officer, Owen Malone, a senior attorney in the SFC's Legal Services Group. The Ethics Officer reviews the financial disclosure statements of the Directors and employees who are required to file and advises each of the actions they must take to correct actual or potential conflicts of interest. The Ethics Officer has also routinely advised the Director of the Office of Government Ethics of each nominee's financial holdings.

The SFC has developed procedures to implement the recusal requirements of Subsection 118(c)(3) of the Act and has incorporated the Act's requirements into its Policy on Standards of Conduct.[62] Prior to any public meeting at which the Board is expected to vote on matters respecting any application, contract, claim, or other particular matter, the Ethics Officer reviews the financial disclosure statements filed by each Director. The Ethics Officer analyzes the interests disclosed by each Director to determine whether any reported interest is within the purview of Subsection 118(c)(1). If the Ethics Officer determines that a Director does have a financial interest pertaining to a matter before the Board, he evaluates the nature and amount of the interest. He considers, for example, whether the interest is held in a trust, whether the Director has control over the asset, and the size of the interest in relation to the Director's total assets and income and in comparison to the company's overall stock issue. The Ethics Officer then writes a letter to each Director outlining his findings in relation to that Director's holdings.

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[60] 42 U.S.C. § 8714(c)(3).

[61] See Debate in the U.S. Senate on the conference report (96-1104) on S. 932, June 19, 1980, reprinted in Compilation of the Energy Security Act of 1980, and 1980 Amendments to the Defense Production Act of 1950, H.R. Committee on Banking, Finance and Urban Affairs, 96th Cong., 2d Sess., p. 473.

[62] Hearing record, pp. 411-13.

Whenever the Ethics Officer determines that a Director does have interests pertaining to a matter before the Board at a given meeting, the Ethics Officer reports publicly to the entire Board. At the open meeting, the Ethics Officer summarizes his evaluation of the interest and recommends whether or not the Board should reach a finding that the interest is "to remote or inconsequential" to affect the integrity of the Director's participation in a given vote of the Board.

To date, the Ethics Officer has made recommendations to the Board concerning financial interests of Directors on approximately 20 occasions. In each instance, the Board has, upon the recommendation of the Ethics Officer, found the interests involved sufficiently remote or inconsequential to waive the recusal requirement. Many of these votes, however, involved the same financial interests of particular Directors, as the Board votes whether to waive the recusal requirement each time a Director's interest relates to a matter before the Board.

3. The Subcommittee's Review

The Subcommittee believes that serious conflicts of interest, as well as the appearance of conflicts of interest, can exist when Directors are in the position to vote on matters which affect their own financial interests. The huge sums of taxpayers' dollars being committed by the Board make it particularly crucial for the public to know that each vote is cast free from personal motivation or financial gain.

The Subcommittee concludes that the SFC has conscientiously administered the financial disclosure and recusal provisions of the Energy Security Act. The Subcommittee recommends, however, that the Committee on Energy and Natural Resources[63] reevaluate the recusal provisions of the Act to determine whether they adequately guard against conflicts of interest within the Board. In reexamining these provisions in light of the experience to date under the Act, the Energy Committee should balance the goal of ensuring public confidence in decisions of the Board with the need to attract qualified, experienced individuals to serve as Directors.

In addition, the Subcommittee finds that the present conflict-of-interest procedures of the SFC should be improved in one area: more up-to-date information on the financial interests of part-time Directors should be available to the Ethics Officer. Currently, the Ethics Officer relies on the financial disclosure statements filed by the Directors in evaluating a Director's interest in relation to matters before the Board. Because most part-time Board members serve less than 60 working days, however, they do not file annual disclosure statements. Consequently, the most recent disclosure statement often available to the Ethics Officer is the statement filed by the Director at the time of his nomination to the Board. In many cases, this information can be sorely out-of-date, especially for directors with terms of up to seven years. This problem will worsen with the appointment of new members to the Board who, by statute, will all have terms of seven years.

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[63] The Senate Committees on Energy and Natural Resources and on Banking, Housing, and Urban Affairs exercised joint jurisdiction in passing the Energy Security Act. The Committee on Energy and Natural Resources would exercise jurisdiction over a change in recusal provisions contained in Section 118 of the Act.

To correct this problem, the Subcommittee recommends that all part-time Directors file annual, confidential financial disclosure statements with the SFC Ethics Officer. Annual confidential financial statements will address the problem of out-of-date information while being consistent with the Office of Personnel Management's regulation found in 5 C.F.R., Part 734.204, that part-time employees are not required to file publicly. The confidential statements should include the same information required by the public financial disclosure system, e.g., income, assets, property of the Director, his or her spouse and dependents, rather than simply update the energy interests held by the Director. In this way, the Ethics Officer will be fully informed in his evaluation of whether a Director should participate in particular matters before the Board.

V. QUESTIONABLE ADMINISTRATIVE EXPENSES

In October 1982, the Office of Inspector General commenced a detailed audit of employee advances, travel and relocation expenses and related administrative costs of the Corporation. The audit, which examined travel and relocation expenses of $400,000 and $500,000 respectively, as well as individual employee advances and travel expenses of $62,000, was designed to discover any instances of fraud, waste and abuse "in what are especially sensitive areas of discretionary reimbursements." [64]

According to SFC procedures, upon concluding an audit, the IG sends his findings to the SFC's Audit Committee, comprised of three Directors. The Corporation then provides its response to the Inspector General's findings and recommendations. After the IG and the Corporation have issued their final determinations, these are sent to the SFC Audit Committee for review and any action the Audit Committee deems appropriate.

In his final audit report submitted to the Corporation on May 10, 1983, the Inspector General concluded that, "Based on the audit work performed, the travel, relocation, and business expense accounts, as adjusted, appear reasonable for the year ended 30 September, 1982, and the employee advances appear to be fairly stated." The Inspector General did, however, question the validity of certain reimbursements to one Officer/Director of the Corporation. Each of the reimbursements and claims questioned involved Victor A. Schroeder, then President of the SFC. Specifically, the Inspector General questioned:

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[64] Report on Internal Audit of Fiscal Year 1982 Travel and Relocation Expenses and Employee Advance Accounts, Office of Inspector General, United States Synthetic Fuels Corporation, May 1983, Hearing Record, pp. 237–51.

1. a reimbursement of $19,500 to Mr. Schroeder for a real estate broker's commission;
2. mortgage rate differential claims totaling $4,770; and
3. over $3,000 in expenses paid to Mr. Schroeder for the period prior to the date he was hired by the SFC.

A. THE $19,500 REAL ESTATE BROKER CLAIM

Mr. Schroeder received $19,500 as reimbursement for a real estate commission on a house he purchased in Alexandria, Virginia on August 20, 1981. In his final audit report, the Inspector General disputed the propriety of this reimbursement by the Corporation on the grounds that the $19,500 amount appeared to be part of the purchase price for the house and thus not reimbursable under the Corporation's relocation policy. The Inspector General's report stated that:

> . . . such commissions are normally paid by the seller; and, neither the old draft policy nor the new adopted policy provide for real estate commission reimbursement on the purchase of a house. The $19,500 on the surface appears to be additional consideration toward the purchase cost of the house. The employee did not sell or pay any selling commission on his former residence. Therefore, no commission seems to be reimbursable under the relocation policy.

At the Subcommittee's hearing, John J. Trant, Internal Auditor for the Inspector General, further explained why he questioned the $19,500 commission:

> Mr. TRANT. Whether the price was marked up or down is hard to say, and it is impossible to say as to whether there is a separate consideration for the $19,500 outside of the contract.
>
> But it was unusual enough that I felt that it was worth raising the question, because it seemed to be in the nature of additional consideration for purchase rather than an expense of relocation.
>
> Senator COHEN. Was there any indication that the price was $325,000 and then later was $305,000?
>
> Mr. TRANT. That was noted in the inner columns as a base purchase price of $305,500, I believe, but the actual figures on the closing statement in the columns showed a selling price of $325,000, with the commission being paid from the seller's funds rather than from the buyer's funds.
>
> Senator COHEN. Did you check to see whether the seller paid a commission?
>
> Mr. TRANT. I did not. I reported the facts, and I understand it was thoroughly investigated by the department of the general counsel.
>
> Senator COHEN. So it showed a final payment of $325,000 as a seller's commission rather than a buyer's commission?
>
> Mr. TRANT. The document shows both things. In the inner columns it shows the commission being paid by the buyer. It has that statement—$305,500, base purchase price, plus com-

> mission—and says the commission is being paid from the down payment.
>
> The actual closing statements, where it tabulates where the dollars come from, it shows a selling price of $325,000, the commission being paid from the seller's funds.

In response to the Inspector General's concerns, the Office of General Counsel conducted a review on behalf of the Corporation to determine whether the payment was allowable within the Corporation's relocation policy. The policy in effect at the time of the transaction provided for reimbursement of "all reasonable selling expenses . . . including mortgage pre-payment penalty, broker's commission, mortgage discount points, duplicate loan carrying costs, etc." For purchase closing costs, the policy provided for reimbursement of only "all normal and reasonable buyer costs."

On April 13, 1983, the Office of General Counsel tentatively concluded that the $19,500 commission was not a "normal and reasonable buyer cost" and therefore must be disallowed.[65] The General Counsel's memorandum supplied the following basis for its conclusion:

> But even if the buyer paid the commission, as recited in the contract of sale and settlement statement, it appears that the lesser price was agreed upon only on condition that the buyer pay a commission the seller was contractually obliged to pay in connection with the transaction. This should be viewed as part of the overall consideration to the seller, so that the transaction involved a $325,000 purchase price, regardless of how denominated in the closing papers. Thus, we view the commission not as a normal and reasonable buyer costs, but as part of the purchase price. We do not believe the negotiations surrounding payment of the commission have altered its essential character so that it would qualify as a normal and reasonable buyer cost rather than the purchase price.

Upon conducting further investigation of real estate practices and relocation policies, the Office of General Counsel issued its final opinion concerning the $19,500 payment in a memorandum to Chairman Noble on June 28, 1983.[66] It concluded that reimbursement to Mr. Schroeder was indeed improper. An informal survey of real estate practices in Northern Virginia had confirmed that it was not common practice for buyers to pay real estate commissions or for employers to reimburse their employees for such payments. The memorandum also stated that, having been advised of the General Counsel's decision, Mr. Schroeder voluntarily agreed to pay the Corporation the $19,500 plus interest and placed this amount in escrow. According to this report, however, Mr. Schroeder restated his firm belief that the reimbursement was made in accord with the Corporation's reimbursement policy. When the Office of General Counsel reached its final decision, Mr. Schroeder's check for $21,742.50 was deposited in the Corporation's account as total repayment for the real estate commission.

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[65] Memorandum to the Chairman, United States Synthetic Fuels Corporation from Andrew P. Tashman, Office of the General Counsel of the United States Synthetic Fuels Corporation, April 13, 1983, Hearing Record, pp. 252–57.

[66] Memorandum to the Chairman, United States Synthetic Fuels Corporation from Andrew P. Tashman, Office of the General Counsel, United States Synthetic Fuels Corporation, June 28, 1983, Hearing Record, pp. 258–63.

Based on the findings of both the Inspector General and the Office of General Counsel, the Subcommittee has concluded that Mr. Schroeder's claim for the $19,500 reimbursement was improper and should not have been made.

B. THE $4,770 MORTGAGE INTEREST RATE DIFFERENTIAL CLAIMS

The Inspector General's Audit also questioned three annual payments of $1,590 claimed by Mr. Schroeder as mortgage interest rate differential payments.

The Corporation's relocation policy in effect at the time Mr. Schroeder purchased his new home provided for "payment for interest rate differences between old and new rate times old mortgage dollar balance for a three-year period [with] payment to be made on annual basis.[67] The Inspector General concluded that three claims made by Mr. Schroeder were "open to question" under this policy because Mr. Schroeder did not sell his former residence or forego the benefits of a lower mortgage interest rate.[68]

In its April 13, 1983, memorandum, the Office of General Counsel concluded that the relocation policy did not explicitly require employees to sell their former residences in order to qualify for the differential payments.[69] The OGC reasoned that the differential may be provided to enable the new employee to purchase a new residence on financing terms comparable to those he had obtained when he financed his principal residence and that, "If this be the purpose, whether he sold his old home or retained it as an investment would not govern eligibility for the differential."

Despite the Corporation's finding, the Inspector General still questioned the differential claims in his May, 1983 report on the grounds that "there is no evidence in the files that mortgage rate differentials apply to any situation other than the sale and purchase of a home connected with a relocation."

In its June 28, 1983, memorandum, the Office of General Counsel affirmed its earlier opinion that the three payments of $1,590 each are allowable under the relocation policy.[70] The OGC noted that consultation with industry representatives had "not developed any evidence of a uniform policy in industry requiring sale of an earlier residence as a condition to payment of the differential for what is in fact the new principal residence."

The Inspector General has informed the Subcommittee that the Corporation's June 28, 1983 analysis of the differential payments does not adequately resolve his concerns regarding these payments. Senator Cohen questioned Inspector General Lessey concerning the propriety of these claims:

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[67] Hearing Record at 255.
[68] Hearing Record at 251.
[69] Hearing Record at 256.
[70] Hearing Record at 262.

> Senator COHEN. . . . If you sell your house and you have a mortgage at 9 percent, and you move to an area and you have to buy another house, you have to pay 12 percent, that is the kind of mortgage interest differential you are talking about?
>
> Mr. LESSEY. Yes sir. This issue here was the fact that the house at the prior location was not sold. This is a second exception that Mr. Trant cited in his audit in that case, yes, sir.
>
> Senator COHEN. What were the findings of the Corporation with respect to those payments?
>
> Mr. LESSEY. The Corporation has allowed the claim for payment, and that is what I was referring to when I said that has been forwarded to the Board of Directors by the Corporation. The Board of Directors has not yet acted upon it.
>
> Senator COHEN. Even if the Audit Committee does not take any action on this, do you have any authority in this matter, any further authority?
>
> Mr. LESSEY. Well, I am supposed to be a persistent junkyard dog, and I am, so I am still reviewing that. But we do our internal audit in coordination with the external auditor, and I have already conferred with my external auditor, and my external auditor on an informal and preliminary basis does not see this as a normal practice.
>
> So I am assuming that the matter will possibly come up for review when the forthcoming external audit is performed.

The Subcommittee endorses the Inspector General's opinion that adequate grounds exist to question the propriety of the claims for $4,770 and believes that the Inspector General and the Audit Committee should take further steps to resolve this matter.

C. THE $3,000 IN EXPENSES PAID TO MR. SCHROEDER BEFORE HE WAS HIRED BY THE SFC

During the course of his audit, the Inspector General questioned reimbursement of over $3,000 in expenses which were claimed by Mr. Schroeder and incurred prior to Mr. Schroeder's date of hiring by the Corporation.[71]

In its April 13, 1983, response to the IG's concerns, the Office of General Counsel noted that expenses incurred in April and May, 1981, were first claimed by Mr. Schroeder as relocation expenses, and as such were disallowed.[72] This decision was reversed in March, 1982, on the basis that Mr. Schroeder was conducting business on behalf of the Corporation. The Office of General Counsel concluded that "passage of time has made it impossible for Mr. Schroeder to reconstruct completely all the business conducted during the period." although he had attempted to construct part of his activities. The OGC noted that Mr. Schroeder's records indicated that he did have substantial contact with the SFC during that period.

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[71] Hearing Record at 251.
[72] Hearing Record at 256.
[73] Hearing Record pp. 264–67.

On June 22, Mr. Schroeder submitted a list of the business activities he conducted during the period in question.[73] In its final report to the Audit Committee, on June 28, 1983, the Office of General Counsel concluded that Mr. Schroeder did have substantial contacts with SFC employees, potential employees, and government officials during the periods for which reimbursements were made. Thus, the Corporation concluded that no further action with regard to these payments is necessary.

Inspector General Lessey testified to the Subcommittee that the Corporation has provided adequate documentation covering this period to justify the $3,000 in expenses paid to Mr. Schroeder.

CONCLUSION

The year 1984 will be a watershed in the history of the Synthetic Fuels Corporation. Congress will decide whether the Corporation's actions warrant the release of billions of tax dollars for investment in synfuels projects in the 1990s or whether the SFC was a flawed experiment that should be terminated.

The Corporation has had a troubled past, marked by management failures, a lack of planning, and slow decisionmaking. The Subcommittee believes, however, that the Corporation is now making progress. The resignation of Victor Schroeder as President should mend the divisions in the Board and permit the Directors to focus their energies on the tasks set forth in the Energy Security Act. The findings and recommendations in this report lay the groundwork for further improvements in the Corporation's operations.

The Subcommittee endorses the continuation of the Synthetic Fuels Corporation based not on its past performance but on its progress and promise. The development of a viable synthetic fuels industry should remain a top priority for the United States. While the current oil glut may have dulled our memories of the long gas lines and home heating oil shortages of the 1970s, we cannot ransom our nation's future by failing to develop dependable, alternative domestic sources of energy. The Middle East is too unstable and our oil resources too limited for us to ignore the reality of future energy shortages.

While the promise of the Energy Security Act has not yet been fulfilled, there is still time for the Synthetic Fuels Corporation to make an enormous contribution to the goal of energy self-sufficiency for our nation. The Subcommittee urges the Corporation to move boldly forward.

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